

# Arizona Department of Liquor Licenses and Control

Department did not handle cash receipts as required, comply with some State- and Department-specific conflict-of-interest requirements, investigate all complaints within established time frames, and had not fully implemented the cocktails and alcohol to-go programs that became effective September 2021

Performance Audit and  
Sunset Review

July 2022  
Report 22-105

A Report to the Arizona Legislature

Lindsey A. Perry  
Auditor General





The Arizona Auditor General's mission is to provide independent and impartial information and specific recommendations to improve the operations of State and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

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July 27, 2022

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Tracy Uffelmann, Director  
Arizona Department of Liquor Licenses and Control

Transmitted herewith is the Auditor General's report, *A Performance Audit and Sunset Review of the Arizona Department of Liquor Licenses and Control*. This report is in response to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Liquor Licenses and Control agrees with all the findings and plans to implement all the recommendations. My Office will follow up with the Department in 6 months to assess its progress in implementing the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

*Lindsey A. Perry*

Lindsey A. Perry, CPA, CFE  
Auditor General

## Arizona Department of Liquor Licenses and Control

Department did not handle cash receipts as required, comply with some State- and Department-specific conflict-of-interest requirements, investigate all complaints within established time frames, and had not fully implemented the cocktails and alcohol to-go programs that became effective September 2021

### Audit purpose

To determine if the Department complied with State cash-handling and conflict-of-interest requirements, issued liquor licenses to qualified applicants, resolved complaints in a timely manner and in accordance with policy, consistently issued disciplinary actions to address violations of State liquor laws, and provide information on the cocktails and alcohol to-go programs and responses to the statutory sunset factors.

### Key findings

The Department:

- Did not protect public monies by properly logging cash received in the mail, timely recording and depositing cash received, and reconciling mail log to amounts recorded and deposited, as required by the *State of Arizona Accounting Manual (SAAM)*, which puts these monies at increased risk of loss or theft and makes them unavailable for the State's timely use.
- Did not comply with some State- and Department-specific conflict-of-interest requirements, increasing risk that employees and public officers had not disclosed substantial interests that might influence their official conduct.
- Issued and renewed licenses to applicants we reviewed who met all applicable licensure requirements and generally issued licenses within established time frames.
- Did not always investigate complaints we reviewed within established time frames, lacked time frames for resolving complaint cases that required disciplinary action, and did not document reasons for deviating from penalty guidelines, as required by its policies.
- Had not fully implemented the cocktails and alcohol to-go program requirements, which became effective September 29, 2021, including not establishing registration requirements for alcohol delivery contractors or evaluating the appropriateness of its funding and staffing for the programs.

### Key recommendations

The Department should:

- Record cash on the day received and deposit as soon as practicable, continue its efforts to develop and implement an accurate mail log and reconcile it to amounts recorded and deposited, and develop and/or revise and implement written policies and procedures to help ensure staff comply with cash-handling requirements in the SAAM.
- Develop and implement conflict-of-interest policies and procedures and update its conflict-of-interest form to include Department-specific statutory requirements.
- Investigate complaints within the time frames established in its policies and procedures, develop and implement time frames for resolving complaints that require disciplinary action, and document explanations for deviations from its penalty guidelines, as required by its policy.
- Establish requirements for registering alcohol delivery contractors and conduct a workload/cost analysis to evaluate the appropriateness of its funding and staffing for the cocktails and alcohol to-go programs.



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The Arizona Auditor General has completed a performance audit and sunset review of the Arizona Department of Liquor Licenses and Control (Department). This performance audit and sunset review determined whether the Department complied with State cash-handling and conflict-of-interest requirements, issued liquor licenses to qualified applicants, resolved complaints in a timely manner and in accordance with Department policy, and consistently issued disciplinary actions to address violations of State liquor laws, and provides information on the cocktails and alcohol to-go programs and responses to the statutory sunset factors.

## Mission, purpose, and responsibilities

The Department was established in 1939 and consists of the Office of the Director of the Department and the State Liquor Board (Board). The Department's mission is to protect public safety and support economic growth through the responsible sale and consumption of liquor, and to efficiently license qualified applicants. The Department's primary statutory responsibilities include:

- **Issuing liquor licenses to qualified applicants**—The Department issues more than 20 different licenses and privileges related to the production, distribution, and sale of spirituous liquors and as of February 2022, reported 15,609 active licenses and privileges (see Appendix A, pages a-1 through a-4, for more information on the active licenses and privileges).<sup>1,2</sup> Statute and rule specify license and privilege requirements, which vary by license type (see textbox for common license requirements).<sup>3</sup> Statute also requires that each license be renewed annually.<sup>4</sup> Some license types—bars, liquor stores, and beer and wine bars—are considered quota licenses and the issuance of these licenses is limited and based on each county's population (see Sunset Factor 2, pages 19 and 20, for additional information about the Department's process for issuing quota licenses). In addition to issuing licenses, statute authorizes the Department to issue interim permits, which allow an applicant to continue operations during a license transfer or replacement period.<sup>5</sup>

### Common license application requirements

- U.S. citizen or legal resident, and Arizona resident.
- Submission of fingerprints for a criminal history records check (no felony 5 years prior).
- Completed liquor law training.
- Floor plan submission for the premises where liquor will be sold, served, consumed, dispensed, possessed, or stored.

Source: Auditor General staff review of A.R.S. §§4-202 and 4-207.01, Department license applications, and interviews with Department staff.

<sup>1</sup> Arizona Revised Statutes (A.R.S.) §4-101(37) defines "spirituous liquor" as alcohol, brandy, whiskey, rum, tequila, mescal, gin, wine, porter, ale, beer, any malt liquor or malt beverage, absinthe, a compound or mixture of any of them or of any of them with any vegetable or other substance, alcohol bitters, bitters containing alcohol, any liquid mixture or preparation that produces intoxication, fruits preserved in ardent spirits, and beverages containing more than ½ of 1 percent of alcohol by volume.

<sup>2</sup> Privileges are additional benefits added to a license, such as allowing patrons to sample spirituous liquor, selling beer in growlers for off-premises consumption, and selling cocktails and alcohol to-go.

<sup>3</sup> State liquor laws are outlined in A.R.S. §4-101 et seq. and supplemented by Arizona Administrative Code (AAC) Title 19, Ch. 1.

<sup>4</sup> A.R.S. §4-209 states that a license may be renewed for a 2-year period if no compliance penalties have been issued during the year before the renewal. However, the Department requires annual renewal for all licenses.

<sup>5</sup> A.R.S. §4-203.01 states that interim permits are issued for a period of not more than 105 days and are available to applicants of the same series of nontransferable license, for the transfer or replacement of a transferable license of the same series, or for the replacement of a hotel-motel license with a restaurant license located at the same premises.

As shown in Figure 1 (see page 3), the Department reviews submitted license and privilege applications for administrative completeness, and is statutorily required to forward most license and privilege applications to the appropriate Local Governing Body (LGB)—such as city or town council or county board of supervisors—for review.<sup>6,7</sup> Statute provides the Department, LGB, and individuals from the community the opportunity to review, protest, and/or recommend the application. Contested applications are heard before the Board, which has the statutory authority to grant or deny the application (see page 5 for more information on the Board's responsibilities).<sup>8</sup> If there are no protests, the Department Director may approve the application and issue the license.

- **Enforcing liquor laws**—The Department is statutorily required to ensure compliance with State liquor laws.<sup>9</sup> The Department primarily does so by investigating complaints, conducting inspections, and performing audits of select license types. The Department's enforcement responsibilities include:
  - **Investigating complaints and allegations of noncompliance**—The Department employs certified peace officers to perform several investigative activities, including covert and overt activities, to investigate complaints alleging violations of State liquor laws. Department officers may also self-initiate an investigation during the course of duty when they witness a violation or are approached by local law enforcement about a violation. The Department also responds to wrong-way driver incidents to investigate potential violations of overservice as it reported that many of these incidents stem from the overconsumption of alcohol. According to Department data, it received 1,125 complaints alleging liquor law violations in fiscal year 2021, with nearly 700 of those complaints alleging violations of the Governor's executive orders related to the COVID-19 pandemic.<sup>10</sup> See Sunset Factor 6, pages 23 through 26, for more information on the Department's complaint investigation and resolution processes.
  - **Conducting inspections**—Statute authorizes the Department to inspect the premises of a licensee to assist with the enforcement of State liquor laws.<sup>11</sup> Most inspections are completed in conjunction with a complaint investigation, but officers may also conduct inspections independent of a complaint. During an inspection, an officer should check compliance with various statute and rule requirements using an inspection checklist, such as determining that the license and fetal alcohol pregnancy signs are posted in the premises, that only authorized alcoholic beverages are on the premises, and that dispensing equipment is labeled. According to Department records, it completed 387 inspections in fiscal year 2021—242 in conjunction with a complaint investigation and 145 independently.
  - **Performing restaurant audits**—Statute authorizes the Department to audit a licensed restaurant's records to determine whether the restaurant has generated at least 40 percent of its revenue from food sales, as required by statute.<sup>12</sup> If a restaurant fails to meet the 40 percent requirement, statute outlines the steps that should be taken, such as allowing the licensee between 6 months and 1 year to continue operating as a licensed restaurant to increase food sales or replacing the restaurant license with a bar or beer and wine bar license. According to Department records, the Department completed 84 restaurant audits in fiscal year 2021.

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<sup>6</sup> According to AAC R19-1-209, an application is considered administratively complete when a liquor license applicant has provided all materials and information prescribed by the application, submitted the application fee, and all required individuals have submitted a complete set of fingerprints for a criminal history records check.

<sup>7</sup> A.R.S. §4-201 requires license applications within an incorporated city or town or unincorporated area to be submitted to the LGB for review. Further, A.R.S. §4-201 requires applications to be reviewed by only 1 LGB. Therefore, if an applicant is within a city or town's limits, the application is submitted to that city or town's LGB, whereas applications from applicants in unincorporated areas are submitted to the county LGB.

<sup>8</sup> A.R.S. §4-112(A).

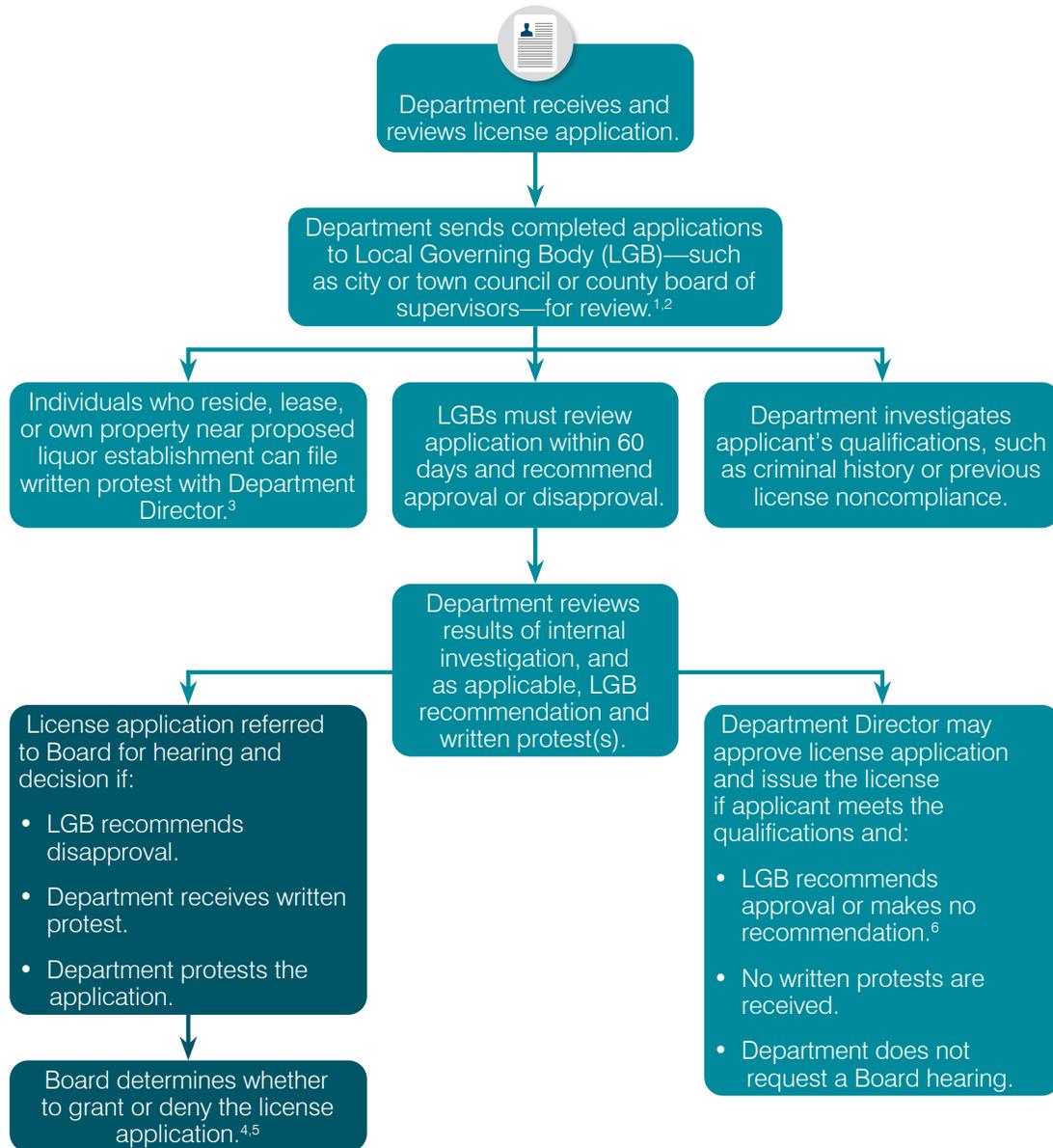
<sup>9</sup> A.R.S. §4-112(C).

<sup>10</sup> According to the Department, common complaints alleging executive order violations included bars being open when not permitted, overcrowding, and patrons playing games, such as billiards, when not permitted.

<sup>11</sup> A.R.S. §4-118.

<sup>12</sup> A.R.S. §4-213.

**Figure 1**  
**License application review and approval process**



<sup>1</sup> A.R.S. §4-201 requires license applications within an incorporated city or town or unincorporated area to be submitted to the city, town, or board of supervisor’s clerk. Therefore, out-of-state license applications, which are not located within the State, are exempt from the LGB process.

<sup>2</sup> The city or town clerk must immediately file a copy of the license application in the clerk’s office and post a copy in a conspicuous place on the front of the premises where the business is proposed for a period of 20 days.

<sup>3</sup> Individuals who reside, own, or lease property within a 1-mile radius of the proposed liquor establishment have 60 days from the application being filed with the Department or 15 days after the LGB makes its recommendation, whichever is sooner, to file a written protest with the Department.

<sup>4</sup> The Board determines whether public convenience requires and the best interest of the community will be substantially served by the issuance/transfer of a liquor license at the proposed location by evaluating criteria outlined in AAC R19-1-702 (see page 5 for more information).

<sup>5</sup> According to A.R.S. §41-1092.09 and AAC R19-1-703, a party may file a motion for rehearing or review of a decision issued by the Board.

<sup>6</sup> No recommendation by the LGB occurs if the LGB fails to make a recommendation to the Department within 60 days after the filing of the application.

Source: Auditor General staff review of A.R.S. §§4-201, 4-202, 4-112, and 41-1092.09, AAC R19-1-209, R19-1-702, and R19-1-703, and interviews with Department staff.

Statute grants the Department the authority to impose disciplinary actions against licensees who violate State liquor laws, including license suspension or revocation.<sup>13</sup> According to the Department's annual report, in fiscal year 2021, the Department revoked 3 and suspended 25 licenses. See Sunset Factor 6, pages 23 and 24, for more information regarding disciplinary options used by the Department.

- **Promoting public safety through education and prevention**—According to the Department, it established a prevention unit in 2016 to focus on reducing underage drinking with the goal of educating the public about the dangers, legal consequences, and possible physiological effects of underage drinking. For example, in fiscal year 2021, the Department reported that its prevention unit hosted 53 alcohol awareness events, primarily at local schools, that were collectively attended by 2,731 teens.<sup>14</sup> Additionally, the prevention unit provides training to law enforcement officers and recruits about liquor laws and fake identification recognition techniques, and in fiscal year 2021, the Department reported that its prevention unit provided 20 of these trainings.

## Organization and staffing

As of May 2022, the Department reported that it had 43 full-time equivalent (FTE) positions—38 filled and 5 vacancies within the following 3 divisions:

- **Legal and Administration (12 FTEs, 2 vacancies)**—Responsible for budgeting and finance, procurement, information technology, communications, special projects, Board administration, and policy research. This division includes the Director and Deputy Director, who were appointed/hired in September and November 2021, respectively. Prior to their appointment/hire, members of the Arizona Department of Public Safety (DPS) were responsible for overseeing and managing the Department's operations after the prior Director and Deputy Director's departure in April 2021. Within this Division are 2 units that fulfill other specific functions:
  - **Compliance**—Adjudicates violations of State liquor laws and rules. Specifically, the compliance unit reviews investigation reports submitted by the Department's Investigations Division for violations and issues penalties to licensees (see Sunset Factor 6, pages 23 through 26, for more information on the Department's process to determine penalties for identified violations).
  - **Auditing**—Monitors and performs audits of licensed restaurants to assess compliance with the statutory requirement that 40 percent of their revenue be derived from food sales. This unit also performs annual audits on all winery, craft distiller, and microbrewery annual production reports.<sup>15</sup>
- **Licensing (11 FTEs, 2 vacancies)**—Responsible for issuing and renewing liquor licenses and providing customer service to the public.
- **Investigations (15 FTEs, 1 vacancy)**—Responsible for investigating complaints alleging violations of State liquor laws and initiating investigations and inspections. The division also includes the prevention unit, which is responsible for education and prevention activities such as law enforcement training on State liquor laws and fake identification, local governing body training, and community outreach and education initiatives.

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<sup>13</sup> In addition to issuing administrative violations against licensees, Department officers can also issue criminal citations against any person who violates State liquor laws.

<sup>14</sup> The Department hosted these educational events in collaboration with the Governor's Office of Youth, Faith and Family and the Governor's Office of Highway Safety.

<sup>15</sup> A.R.S. §§4-205.04, 4-205.08, and 4-205.10 requires wineries, microbreweries, and craft distilleries to report annually the amount of wine, beer, or distilled spirits, respectively, produced or manufactured. As such, the Department requires these licensees to submit an annual production report.

Additionally, the Department was responsible for implementing the cocktails and alcohol to-go programs, as required by Laws 2021, Ch. 375 (see Questions and Answers, pages 30 through 35, for additional information about the cocktails and alcohol to-go programs).

## Board responsibilities and composition

As required by A.R.S. §4-112(A), the Board is responsible for granting and denying liquor license applications, holding hearings, hearing appeals of Board or Department Director decisions, and adopting rules.<sup>16</sup> Statute further requires the Board to adopt, by rule, guidelines that govern how the Board, Department, and LGBs determine whether public convenience requires and the best interest of the community will be substantially served by issuing or transferring a license (see textbox for license evaluation guidelines).<sup>17</sup>

The Board operates independently from the Office of the Director of the Department. As required by A.R.S. §4-111, the Board consists of 7 Governor-appointed members who serve 3-year terms, 5 of whom must not be financially interested directly or indirectly in a business licensed to deal with spirituous liquors, and 2 of whom must be currently or previously engaged in the spirituous liquor industry.<sup>18</sup> Statute further requires Board members to be an Arizona resident for a minimum of 5 years before their appointment. Additionally, a maximum of 4 members can be from the same political party and no more than 3 members can be from the same county.

### License evaluation criteria

The Board, Department, and LGBs may consider some of the following criteria when determining whether to grant a license:

- Petitions and testimony from individuals in the community that favor or oppose the liquor license application.
- Number and types of liquor licenses within 1 mile of the proposed premises.
- Residential and commercial population projections and population density.
- Impact on local vehicular traffic, businesses, and residences.
- Past 5 years of liquor violations and reported criminal activity at the proposed premises.
- Proximity to licensed childcare facilities.

Source: Auditor General staff review of A.R.S. §4-201(I) and AAC R19-1-702.

As of May 2022, the Board reported 6 filled and 1 vacant member position for a member who does not have a financial interest in the liquor industry.<sup>19</sup> The Board is supported by 1 administrator who schedules hearings and provides administrative support and legal assistance to the Board.

## Revenues and expenditures

As shown in Table 1 (see page 6), the Department does not receive any State General Fund appropriations. Instead, its revenues consist primarily of licensing and fee revenues collected from licensees and applicants. The Department is statutorily required to remit various revenues to the State General Fund and State counties. The majority of the Department's expenditures are for payroll and related benefits, but also include expenditures for professional and outside services, travel, and other operating expenses, such as rent, insurance, and information technology costs. The Department's fund balance was estimated to be nearly \$3.2 million at the end of fiscal year 2022.

<sup>16</sup> Per A.R.S. §4-210.02, any aggrieved party may appeal any final decision of the Director regarding applicants or licenses to the Board. The aggrieved party must appeal in writing to the Department within 15 days after service of the notice of the Director's decision. The Director's decision is suspended until the determination of any appeal by the Board.

<sup>17</sup> A.R.S. §4-201(I) and AAC R19-1-702.

<sup>18</sup> At least 1 of the 5 members who is not financially interested in the liquor industry must be a current elected municipal official and at least 1 of the 2 industry-related members must be a current retail licensee or the employee of a retail licensee. Additionally, 1 must be a member of a neighborhood association recognized by a county, city, or town.

<sup>19</sup> According to the Department, as of April 2022, the vacant member position is in the process of being filled.

**Table 1**  
**Schedule of revenues, expenditures, and changes in fund balance**  
**Fiscal years 2020 through 2022**  
(Unaudited)

	2020 (Actual)	2021 (Actual)	2022 (Estimate)
<b>Revenues</b>			
Licensing and fees	\$10,726,746	\$10,113,702	\$11,084,229
Fines, forfeits, and penalties	666,973	648,224	482,440
Intergovernmental			
Federal pandemic aid <sup>1</sup>	126,738		
Federal grants	265,880	233,355	175,182
Charges for services <sup>2</sup>		7,269	
<b>Total gross revenues</b>	<b>11,786,337</b>	<b>11,002,550</b>	<b>11,741,851</b>
Net credit card	(7,433)	(4,171)	(3,600)
Remittances to the State General Fund <sup>3</sup>	(6,161,123)	(5,143,124)	(6,564,397)
Remittance to counties <sup>4</sup>	(458,454)	(430,485)	(421,777)
<b>Total net revenues</b>	<b>5,159,327</b>	<b>5,424,770</b>	<b>4,752,077</b>
<b>Expenditures and transfers</b>			
Payroll and related benefits	3,384,595	3,722,242	3,313,561
Professional and outside services <sup>5</sup>	272,778	311,265	183,753
Travel	130,613	99,228	109,820
Other operating <sup>6</sup>	741,622	658,275	867,595
Furniture and equipment	52,784	15,987	13,138
Transfers to other agencies <sup>7</sup>	1,641	104,975	200,000
<b>Total expenditures and transfers</b>	<b>4,584,033</b>	<b>4,911,972</b>	<b>4,687,867</b>
Net change in fund balance	575,294	512,798	64,210
Fund balance, beginning of year	2,013,305	2,588,599	3,101,397
<b>Fund balance, end of year</b>	<b>\$2,588,599</b>	<b>\$3,101,397</b>	<b>\$3,165,607</b>

- <sup>1</sup> Federal pandemic aid revenues consist of monies received in fiscal year 2020 from the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act to pay for necessary expenditures incurred due to the public health emergency caused by COVID-19, such as paying the costs for Department officers to investigate allegations of noncompliance with the Governor's COVID-19 executive orders.
- <sup>2</sup> Charges for services in fiscal year 2021 were a reimbursement from the Arizona Department of Administration, Risk Management Division for payments the Department made for legal services.
- <sup>3</sup> The Department was required to remit various revenues to the State General Fund, including remitting monies from the Liquor License Fund to the State General Fund for licensing and fees revenues that were more than the Department's annual appropriation in accordance with A.R.S. §4-115(A) and all monies exceeding \$700,000 in the Liquor License Fund at the end of the fiscal year, in accordance with A.R.S. §4-120.
- <sup>4</sup> Represents licensing and fees revenues transferred to Arizona counties in accordance with A.R.S. §4-115(B).
- <sup>5</sup> Professional and outside services expenditures were primarily for legal services and a business and information technology consultant.
- <sup>6</sup> Other operating expenditures consisted of rent; telecommunication; office, computer, and other operating supplies; information technology and software support; insurance; and maintenance expenditures.
- <sup>7</sup> Transfers to other agencies were for various purposes in accordance with interagency service agreements. For example, the Department transferred \$1,641 in fiscal year 2020 and \$4,715 in fiscal year 2021 to the Office of Administrative Hearings for hearing costs. In addition, the Department transferred nearly \$83,000 in fiscal year 2021 and an estimated \$163,000 in fiscal year 2022 to the DPS as part of an interagency service agreement for DPS employees to supervise, oversee, and manage the Department's operations.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2020 and 2021; the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021; and Department-provided estimates for fiscal year 2022.



## Department did not protect public monies, increasing risk of loss or theft and delaying State’s use of monies

### Department has not implemented important State requirements to protect public monies

The *State of Arizona Accounting Manual* (SAAM) classifies cash and cash equivalents (cash) collected by State agencies as public monies that should be protected.<sup>20,21</sup> The SAAM specifies several requirements for handling cash that all State agencies are required to follow to properly protect these monies and reduce the risk of loss or theft. The Department accepts cash in person, by mail, and online for licensing fees, fines, and penalties. However, we found that the Department lacked some important cash-handling controls required by the SAAM. Specifically, the Department:

- **Did not log or properly log cash received in the mail**—The SAAM requires agencies to have 2 State employees who are not responsible for maintaining accounting records to be present when mail is opened and to log cash receipts. The log, which is required to be signed by both employees, should include the name of the remitter; purpose of the remittance; amount of remittance; and form of remittance, such as cash, check, or money order. However, as of December 2021, the Department had not maintained a log to document cash payments received in the mail. During the audit, the Department reported it had begun logging cash received in the mail. However, our review of the Department’s February 7, 2022, log identified various data entry errors and that it was missing required elements, including the signature of 2 employees present when mail was opened, name of the remitter, purpose of the remittance, amount of remittance, and form of remittance, such as cash, check, or money order, and in some cases was prepared by an employee responsible for maintaining accounting records.
- **Did not timely record in the cash receipt systems and deposit all cash received**—The SAAM requires agencies to record all cash received, regardless of whether it is received through the mail, in person, or online, on the same day it is received by using, for example, pre-numbered receipts or a cash receipt system, and to deposit cash with the State Treasurer as soon as practicable, and in most cases this should also be on the same day received.<sup>22</sup> The SAAM further requires that cash be secured in a locked safe if it is not deposited on the day received. Although the Department uses its Electronic Liquor Licensing

<sup>20</sup> The SAAM contains the State’s accounting policies and procedures and is published by the Arizona Department of Administration’s General Accounting Office in accordance with statute.

<sup>21</sup> According to the SAAM, cash equivalents include monies received in various forms, such as checks, money orders, warrants, electronic fund transfers, and payment cards.

<sup>22</sup> SAAM 20.10.7 requires monies to be deposited as soon as practicable and in most cases, on the day received. If making a deposit on the day of collection is impracticable, receipts must be deposited by the end of day after monies total \$1,000 or more, and within 5 days for monies totaling \$50 or more.

and Investigations (ELLI) system and AFIS to record payments, and secures cash in a locked safe prior to deposit, the Department exceeded the required recording and depositing time frames.<sup>23</sup> Specifically:

- Our initial review of the Department's safe in December 2021 found that cash had been in the safe for as long as 8 months without being deposited. For example, we identified 364 checks that were dated between April and December 2021 for various amounts.<sup>24</sup>
  - We conducted a second review of the Department's safe in February 2022 and found that cash had been in the safe for as long as 5 months without being recorded or deposited. Specifically, we identified 305 checks that the Department received between September 2021 and February 2022 totaling \$62,691. The safe also contained \$5,210 in cash; however, it is unknown how long the Department held this \$5,210 in cash in its safe because the receipt of most of these cash payments had not been logged.
  - Finally, we reviewed a judgmental sample of 35 transactions that the Department completed over a 28-month period, including the corresponding deposit documents, and found that at least 5 of these transactions exceeded required recording and depositing time frames by 2 to 120 days.<sup>25</sup> These 5 transactions included a total of 156 individual cash receipts totaling \$64,995. Additionally, for another 6 transactions processed prior to September 2020, we could not determine the timeliness of these deposits because the Department did not retain the detailed documentation necessary to identify the date the cash payments were received.
- **Did not reconcile mail log to amounts recorded and deposited and errors on log can impede reconciliation when performed**—The SAAM requires agencies to reconcile cash amounts on the mail log with cash recorded and deposited and that all discrepancies be promptly and properly resolved by State employees not responsible for logging, recording, or depositing monies. Although the Department had procedures for reconciling amounts recorded in its ELLI system and AFIS to amounts deposited and had maintained these records consistent with the SAAM requirements, it does not reconcile these amounts to the mail log it developed during the audit.

Additionally, as previously reported, our review of the February 2022 mail log identified various errors. These errors could impede the Department's reconciliations. We compared the contents of the safe to the Department's February 2022 log and identified several differences. Specifically, we identified 158 checks totaling approximately \$200,059 and 29 cash payments totaling \$3,086 that were recorded on the Department's log as being in the safe but were actually not located in the safe. Our review of a sample of 16 of these differences found the monies had been recorded and deposited, but the status of these payments was not accurately reflected in the log.<sup>26</sup>

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<sup>23</sup> ELLI is the Department's electronic licensing system, which it uses for various key functions, such as processing and issuing initial and renewal licenses, documenting investigations of noncompliance and assessing fines and penalties, and recording the cash payments for licensing fees, fines, and penalties. AFIS is the State's accounting system and the source of the State's annual financial statements. The Department is responsible for recording cash receipts in both ELLI and AFIS.

<sup>24</sup> Our initial review of the Department's safe focused on the length of time cash receipts had been held in the safe without being deposited; it did not include a calculation of all amounts in the safe at that time.

<sup>25</sup> We reviewed a judgmental sample of 35 transactions totaling approximately \$8,857,657 from the 14,707 transactions totaling \$24,694,675 recorded in AFIS for the period July 1, 2019, through October 31, 2021. We sampled these transactions based on their classification, which included licensing fees, fines, penalties, and other licensing fees, such as fair market value payments for quota liquor licenses. See Appendix A, page a-1 through a-4, for additional information about licensing fees and surcharges.

<sup>26</sup> We reconciled the Department's mail log to the contents of its safe as of February 7, 2022, and identified 158 checks totaling approximately \$200,059 and 29 cash payments totaling \$3,086 on the Department's log that were not included in the safe. We reviewed a random sample of 6 cash payments totaling \$1,154 and 10 checks totaling approximately \$171,067 to determine if these amounts had been recorded and deposited.

## Public monies at increased risk of loss or theft and were unavailable for the State's timely use

In fiscal year 2022, the Department collected an estimated \$11.5 million in cash for licensing fees and fines, which are public monies. Although we did not identify any improper transactions in the samples we reviewed, the Department's noncompliance with the SAAM requirements for protecting public monies increased the risk of loss or theft of these public monies. Further, by not timely depositing the cash it received, these public monies were unavailable for the State's timely use.

## System configuration and lack of procedures hinder Department's ability to protect public monies

- **Department did not configure its ELLI system to record some monies upon receipt, thereby delaying deposits, and had not developed alternative procedures to help ensure timely deposits**—According to the Department, its ELLI licensing system was not configured to allow it to record some cash payments at the time its staff receive the payments, and it did not deposit these cash payments before they were recorded in ELLI because the Department believed it would create an administrative burden for its staff. Specifically, the Department's system was configured to allow initial license application payments to be recorded only after a license applicant's account is created in the ELLI system. However, initial license applications require Department staff to verify and/or obtain some information from the applicant or other parties to create the license applicant's account, and Department staff were not recording initial license application payments in ELLI until the additional information was verified and/or received. Further, the Department had not developed alternative procedures for timely depositing these initial application payments. For example, the Department could have logged these payments with sufficient information—such as name of the remitter, purpose of the payment, and payment amount—to record the monies received, timely deposited the monies, and then relied on the log to record the information in ELLI once the account was created.

In April 2022, as a result of our audit, the Department modified its ELLI system to allow for the creation of a license applicant's account and post an initial license payment without needing to first verify and/or receive the additional information from the applicant or other parties to create the account. According to Department staff, this system modification will allow staff to record initial application payments on the day they are received.

- **Department was unaware of some SAAM requirements for protecting public monies and therefore lacked procedures for following these requirements**—Although the Department had implemented some policies and procedures to protect public monies, such as securing cash it receives in a locked safe and as of September 2020, maintaining detailed documents to better track the payments it receives, it was unaware of other requirements for protecting public monies and had not developed the necessary procedures to do so. Specifically, prior to the audit, the Department did not log cash received in the mail because it reported not being aware of the SAAM requirements for doing so. Although it has begun to do so, as previously reported, the Department's log is missing required elements and includes various errors. Additionally, the Department did not have procedures for recording monies upon receipt and depositing monies as soon as practicable.

### Recommendations

The Department should:

1. Record cash on the day received and deposit as soon as practicable, as required by the SAAM.
2. Continue its efforts to develop and implement an accurate mail log that includes:
  - Signatures from 2 employees not responsible for accounting records and who are present when the mail is opened.

- Name of remitter; purpose of the remittance; amount of remittance; and form of remittance, such as cash, check, or money order.
3. Reconcile the mail log to amounts recorded and deposited and maintain documentation of the reconciliations, ensuring all cash received is recorded and deposited and discrepancies are investigated and resolved by employees who are not responsible for logging, recording, or depositing receipts, as required by the SAAM.
  4. Develop and/or revise and implement written policies and procedures to help ensure staff comply with cash-handling requirements in the SAAM, including those outlined in recommendations 1 through 3.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendations.



## Department did not comply with some State- and Department-specific conflict-of-interest requirements, increasing risk that employees and public officers had not disclosed substantial interests that might influence or could affect their official conduct

### Statute addresses conflicts of interest for public agency employees and public officers and the Department’s employees and Board members are subject to additional conflict-of-interest requirements

Arizona law requires employees of public agencies and public officers to avoid conflicts of interest that might influence or affect their official conduct. To determine whether a conflict of interest exists, employees/public officers must first evaluate whether they or a relative has a “substantial interest” in (1) any contract, sale, purchase, or service to the public agency or (2) any decision of the public agency.

If an employee/public officer or a relative has a substantial interest, statute requires the employee/public officer to fully disclose the interest and refrain from voting upon or otherwise participating in the matter in any way as an employee/public officer.<sup>27,28</sup>

The interest must be disclosed in the public agency’s official records, either through a signed document or the agency’s official minutes. To help ensure compliance with these statutory requirements, the Arizona Department of Administration’s (ADOA) *State Personnel System Employee Handbook* and conflict-of-interest disclosure form (disclosure form) require State employees to disclose if they have any business or decision-making interests, secondary employment, and relatives employed by the State at the time of initial hire and anytime there is a change. The ADOA disclosure form also requires State employees to attest that they do not have any of these potential conflicts, if applicable, also known as an “affirmative no.” In addition, A.R.S. §38-509 requires public agencies to maintain a special file of all documents necessary to memorialize all disclosures of substantial interest, including disclosure forms and official meeting minutes, and to make this file available for public inspection.

#### Key terms

- **Substantial interest**—Any direct or indirect monetary or ownership interest that is not hypothetical and is not defined in statute as a “remote interest.”
- **Remote interest**—Any of several specific categories of interest defined in statute that are exempt from the conflict-of-interest requirements. For example, an employee or public officer who is reimbursed for actual and necessary expenses incurred while performing official duties.

Source: Auditor General staff review of A.R.S. §38-502 and the *Arizona Agency Handbook*. Arizona Office of the Attorney General. (2018). *Arizona agency handbook*. Phoenix, AZ. Retrieved 3/29/22 from <https://www.azag.gov/outreach/publications/agency-handbook>.

<sup>27</sup> See A.R.S. §§38-502 and 38-503(A) and (B).

<sup>28</sup> A.R.S. §38-502(8) defines “public officer” as all elected or appointed officers of a public agency established by charter, ordinance, resolution, State constitution, or statute. According to the *Arizona Agency Handbook*, public officers include directors of State agencies and members of State boards, commissions, and committees—whether paid or unpaid.

Department employees and Board members are also subject to additional statutory conflict-of-interest requirements. Specifically, A.R.S. §4-114 states that no member of the Board, except for a member designated to be appointed from the spirituous liquor industry, nor the Department Director or any Department employee, shall be financially interested, directly or indirectly, in any business that is licensed to deal in spirituous liquors. This statute also states that any Department employee who violates this statute shall be immediately dismissed and that a violation by any Board member or the Department Director is considered a resignation.

Finally, in response to conflict-of-interest noncompliance and violations investigated in the course of our work, such as employees/public officers failing to disclose substantial interests and participating in matters related to these interests, we have recommended several practices and actions to various school districts, State agencies, and other public entities.<sup>29</sup> Our recommendations are based on guidelines developed by public agencies to manage conflicts of interest in government and are designed to help ensure compliance with State conflict-of-interest requirements by reminding employees/public officers of the importance of complying with the State's conflict-of-interest laws.<sup>30</sup> Specifically, conflict-of-interest recommended practices indicate that all public agency employees and public officers complete a disclosure form annually to help remind them to update their disclosure form if their circumstances change and that the form include a field for the employee/public officer to provide an "affirmative no," if applicable. These recommended practices also indicate that agencies develop a formal remediation process and provide periodic training to ensure that identified conflicts are appropriately addressed and help ensure conflict-of-interest requirements are met.

## Department did not comply with some State- and Department-specific conflict-of-interest requirements and its conflict-of-interest processes were not fully aligned with recommended practices

The Department did not comply with some State- and Department-specific conflict-of-interest requirements, and its conflict-of-interest process was not fully aligned with recommended practices designed to help ensure that Department employees and Board members comply with State requirements. Specifically, the Department:

- **Did not require employees to complete a disclosure form upon hire**—The Department does not require its employees to complete a disclosure form when they are hired and to update the form when their circumstances change, as required by ADOA and to ensure compliance with Department-specific conflict-of-interest requirements in A.R.S. §4-114.
- **Used a disclosure form for Board members that did not address all statutorily required disclosures**—The Department developed a conflict-of-interest disclosure form for Board members to complete when they have a conflict with a specific Board meeting agenda item. However, the form did not specifically require disclosures of substantial financial or decision-making interests in contracts, sales, purchases, and services of the Board, as required by statute.<sup>31</sup> Although the Board's disclosure form referenced the State's conflict-of-interest statutes, it did not provide specific examples or guidance to help Board members know the required conflicts to disclose. Additionally, it did not require disclosures specific to A.R.S. §4-114 for applicable Board members.

<sup>29</sup> See, for example, Auditor General Reports 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

<sup>30</sup> Recommended practices we reviewed included: Organization for Economic Cooperation and Development (OECD). (2021). *Recommendation of the Council on OECD guidelines for managing conflict of interest in the public service*. Paris, France. Retrieved 3/29/2022 from <https://legalinstruments.oecd.org/public/doc/130/130.en.pdf>; Ethics & Compliance Initiative (ECI). (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 3/29/2022 from <https://www.ethics.org/wp-content/uploads/2021-ECI-WP-Conflicts-of-Interest-Defining-Preventing-Identifying-Addressing.pdf>; and Controller and Auditor General of New Zealand. (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 3/29/2022 from <https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf>.

<sup>31</sup> A.R.S. §38-503.

- **Lacked a special disclosure file**—The Department did not maintain a special disclosure file to store employees' and Board members' disclosures of substantial interest for public inspection, as required by statute.<sup>32</sup>

Finally, although not required by statute or ADOA, the Department has not fully aligned its conflict-of-interest processes with recommended practices, as follows:

- Did not annually remind its employees to complete a disclosure form when their circumstances change. Similarly, the Department did not require Board members, who are public officers, to complete a disclosure form when appointed or annually remind them to complete a disclosure form when their circumstances change.
- Has not consistently provided its conflict-of-interest form to Board members for use during Board meetings. Specifically, Department staff reported that historically, the Department provided a blank copy of the disclosure form to Board members in their hard copy meeting materials to make the form available for use during in-person meetings. However, in May 2020, the Board began holding its meetings virtually and Department staff reported that Board members were no longer provided the disclosure form in their meeting materials. Additionally, Department staff reported that they have not received a signed disclosure form from a Board member since approximately 2016 or 2017.
- Has not developed or implemented a remediation process for conflicts disclosed by Department employees or Board members.
- Has not developed and implemented periodic conflict-of-interest training for its employees related to their unique programs, functions, or responsibilities.

## **Department's noncompliance with State- and Department-specific conflict-of-interest requirements increased risk that employees and Board members did not disclose substantial interests that might influence or affect their official conduct**

The Department's noncompliance with State and Department-specific conflict-of-interest requirements and not aligning its conflict-of-interest process with recommended practices increased the risk that Department employees and Board members would not disclose substantial interests that might influence or affect their official conduct and/or employment or appointment. For example, by not requiring employees and Board members to complete a disclosure form that addresses all statutorily required disclosures upon hire or appointment, or by not annually reminding them to update their form as their circumstances change, the Department and Board could not ensure that all employees/Board members disclosed both financial and decision-making substantial interests and refrained from participating/voting in any manner related to these interests, as required by statute.<sup>33</sup> Further, the Department could not ensure that all employees and Board members disclosed direct or indirect financial interest with businesses licensed to deal in spirituous liquors. Consequently, the Department may have been unaware of potential conflicts of interest and the need to take action related to those conflicts, such as reassigning employee job duties or ensuring that Board members refrain from participating in and voting on matters with which they have a conflict, or dismissing employees or Board members who have financial interests in a business that is licensed to deal in spirituous liquors, as required by A.R.S. §4-114.

Additionally, because the Department did not collect signed disclosure forms from its employees and did not maintain completed forms from its Board members, the Department was unable to store disclosed conflicts

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<sup>32</sup> A.R.S. §38-509.

<sup>33</sup> A.R.S. §38-503.

of substantial interest in a special file and make this information available in response to public requests, as required by statute.

## Department lacks conflict-of-interest policies and procedures, but started developing a conflict-of-interest process during the audit that aligns with some State-specific requirements

The Department has not developed conflict-of-interest policies and procedures, despite our 2015 review of the Department's practices that recommended the Department develop them.<sup>34</sup> Specifically, the Department lacked policies and procedures that explain the required elements of disclosure for both Department employees and Board members, how the Department would review and remediate conflicts of interest for Department employees and Board members, the consequences of noncompliance, or requirements for conflict-of-interest training. Additionally, Department management reported that they believed A.R.S. §4-114 was the only statute related to conflict of interest relevant to the Department. However, our 2015 review of the Department's practices recommended that it establish policies to ensure compliance with the State's conflict-of-interest laws and the Department agreed to implement the recommendation.

As of March 2022, and in response to our audit, the Department began requiring employees to complete the ADOA conflict-of-interest disclosure form, and as of April 2022, the Department had collected completed forms from all of its employees. However, the Department's communication to employees about the ADOA conflict-of-interest disclosure form did not include information about the Department's specific conflict-of-interest statute, A.R.S. §4-114, nor did the Department account for this additional requirement on its disclosure form. Additionally, Department staff reported that completed disclosure forms would be maintained in employee personnel files, and as such, still lacks a special disclosure file to store disclosures of substantial interest for public inspection, as required by statute.<sup>35</sup> Further, as of April 2022, the Department had not developed conflict-of-interest policies and procedures. Finally, the Board received conflict-of-interest training during its April 2022 Board meeting, in which 5 of the 6 Board members were present, and as of May 2022, the Department had collected completed disclosure forms from 2 of the 6 Board members.

### Recommendations

The Department should:

5. Update its conflict-of-interest disclosure form to include the additional requirements specified in A.R.S. §4-114 that are applicable to Department employees and Board members, and continue to ensure that its conflict-of-interest disclosure form addresses both financial and decision-making conflicts of interest for employees/Board members and their relatives, as required by statute.
6. Develop and implement conflict-of-interest policies and procedures to help ensure compliance with all State conflict-of-interest requirements, including A.R.S. §4-114, that require:
  - a. All Department employees and Board members to complete a conflict-of-interest disclosure form upon hire or appointment, including attesting that no conflicts exist, if applicable, and reminding them at least annually to update their disclosure form when their circumstances change, consistent with State requirements and recommended practices.
  - b. Using the updated conflict-of-interest disclosure form as recommended in Recommendation 5.
  - c. Storing all substantial interest disclosures, including disclosure forms and meeting minutes, in a special file available for public inspection, as required by statute.

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<sup>34</sup> Arizona Auditor General Report 15-305 *Arizona Department of Liquor Licenses and Control—Procedural Review*.

<sup>35</sup> Based on the forms we reviewed, no employees or Board members have disclosed an interest. However, the forms used by the Department do not include the requirements specified in A.R.S. §4-114 and not all Board members had completed a form at the time of our review.

- d. Establishing a process to review and remediate disclosed conflicts, consistent with recommended practices.
7. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees and Board members on how the State's conflict-of-interest requirements and A.R.S. §4-114 relate to their unique programs, functions, or responsibilities.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendations.



Pursuant to A.R.S. §41-2954(D), the legislative committees of reference shall consider but not be limited to the following factors in determining the need for continuation or termination of the Department. This sunset factor analysis includes additional findings and recommendations not discussed earlier in the report.

**Sunset factor 1: The objective and purpose in establishing the Department and the extent to which the objective and purpose are met by private enterprises in other states.**

The Department was established in 1939 and consists of the Board and the Office of the Director of the Department. The Department's statutory responsibilities include issuing liquor licenses to qualified applicants that produce, distribute, or sell spirituous liquor, such as restaurants, distillers, distributors, liquor stores, and bars; investigating suspected noncompliance with State liquor laws; and conducting audits of licensed restaurant establishments. The Board's responsibilities are to grant and deny license applications in accordance with State law, adopt rules in order to carry out various provisions of statute, and hold hearings and appeals of Board or Department Director decisions, as provided in statute.

We did not identify any states that met the Department's objective and purpose through private enterprises. According to the U.S. Department of Treasury Alcohol and Tobacco Tax and Trade Bureau, each state has the authority, through the U.S. Constitution, to regulate the production, sale, and distribution of alcohol within its borders.<sup>36</sup> In addition, we judgmentally selected and reviewed the regulation of alcohol in 3 states as part of our sunset factor work—Florida, New Mexico, and Oklahoma—and found that none used private enterprises to regulate the production, sale, and distribution of alcohol within its state.

**Sunset factor 2: The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated.**

The Department has established processes that help it meet its statutory responsibility to process applications and issue licenses to qualified applicants. Specifically, the Department:

- **Issued and renewed licenses to applicants we reviewed who met applicable licensure requirements**—Our review of 30 initial and renewal license applications found that the Department ensured that applicants met all applicable requirements in statute and rule prior to issuing or renewing a license, such as submitting fingerprints for a criminal history records check, premise floor plans, and restaurant operation plans (see page 20 for more information on 1 area for improvement related to fingerprints and out-of-state license applications).<sup>37</sup>
- **Generally issued licenses in accordance with time frames for licenses we reviewed**—The Department generally issued licenses within established time frames for the random sample of 20 initial license applications we reviewed. A.R.S. §4-201(E) and AAC R19-1-209(C) require the Department to act on most license applications in 105 days—75 days for an administrative completeness review and 30

<sup>36</sup> Alcohol and Tobacco Tax and Trade Bureau. (2021). *Alcohol beverage authorities in United States, Canada, and Puerto Rico*. Washington, DC: U.S. Department of the Treasury. Retrieved 1/3/2022 from <https://www.ttb.gov/wine/alcohol-beverage-control-boards#US>.

<sup>37</sup> We reviewed a random sample of 30 applications for licenses issued/renewed in fiscal year 2021, including 20 of the 2,628 initial licenses and 10 of the 14,104 renewal licenses.

days for a substantive review.<sup>38,39</sup> The Department processed 19 of 20 initial license applications within these time frames. For 1 initial license application, although the Department issued the application within the overall time frame of 105 days, it exceeded its substantive review time frame by 23 days. Department staff attributed this delay to staffing shortages and the COVID-19 pandemic. Additionally, the Department processed the random sample of 10 renewal license applications we reviewed within 1 and 22 days.<sup>40</sup>

However, we identified the following deficiencies in Department processes. Specifically, the Department:

- **Has not fully implemented the cocktails and alcohol to-go State law**—Laws 2021, Ch. 375, amended and added statutory provisions that modified and added privileges for existing licensees and created a new registration type for individuals to deliver mixed cocktails or spirituous liquor for off-premises consumption. To implement the provisions of Laws 2021, Ch. 375, the Department needed to establish application fees, develop applications, and provide education to the public on various aspects of the new law. See Questions and Answers, pages 30 through 35, for more information about these programs and their provisions. However, because these requirements are relatively new and became effective September 29, 2021, the Department reported that it has not had time to either fully implement or ensure it has the resources to oversee these statutory provisions. Specifically, the Department:
  - **Has not registered any alcohol delivery contractors or established registration requirements**—Laws 2021, Ch. 375, allows the Department to register persons who are at least 21 years old as an alcohol delivery contractor to deliver spirituous liquor from a licensed bar, liquor store, beer and wine bar, beer and wine store, or restaurant to a consumer in Arizona. However, as of May 2022, although the Department has developed an application form and received 1 registration application, it has not registered any alcohol delivery contractors. Further, it has not established the registration requirements. For example, the Department has not identified in rule, policy, or procedure who needs to register with the Department and the requirements for doing so, such as submitting fingerprints for a criminal history records check to verify that applicants do not have a felony conviction.<sup>41</sup>
  - **Has not evaluated the appropriateness of its funding and staffing level for administering cocktails and alcohol to-go programs**—In fiscal year 2022, the Department was appropriated \$1,025,000 and 6 FTE positions for the administration of the cocktails and alcohol to-go programs. This included a one-time \$200,000 appropriation for related automation costs. Department staff reported that the remaining and ongoing appropriations will be used to pay for the costs associated with employing 6 FTE positions to administer the cocktails and alcohol to-go programs. However, although the Department completed a workload analysis to determine application fees for the cocktails and alcohol to-go programs, it has not performed a workload analysis or otherwise evaluated whether this funding and staffing level is appropriate for administering the cocktails and alcohol to-go programs. See Questions and Answers, page 35, for more information regarding the Department's costs and workload analysis, and 6 FTE established with the appropriations.
- **Has not evaluated the appropriateness of its fees**—The Department lacks fee-setting policies and procedures for evaluating the appropriateness of its fees to help ensure they are commensurate with the costs of its regulatory activities. Government fee-setting standards and guidance state that fees should be based on the costs of providing a service and reviewed periodically to ensure fees are based on these

<sup>38</sup> Per AAC R19-1-209(D), the Department's time frames for issuing special event and festival/fair licenses is 30 days.

<sup>39</sup> The administrative completeness review time frame is the time Department staff have available to ensure the application is complete before it is submitted to the LGB for review (see page 2, footnote 6 for more information about administrative completeness reviews). The substantive review time frame is the time that the Department or Board has to review the LGB's recommendation and the licensee's qualifications for licensure before making a decision to issue or deny a license (see Figure 1, page 3, for an overview of the license review and approval process).

<sup>40</sup> We did not identify a time frame in statute or rule for renewal license applications.

<sup>41</sup> According to A.R.S. §4-205.13, the Department may not register any person as an alcohol delivery contractor if the person has a felony conviction within 5 years immediately preceding the application.

costs.<sup>42</sup> Although the Department's fee structure, as outlined in A.R.S. §4-209, was largely established in 1986, the Department was unable to verify when its fees were last reviewed and modified. For example, Laws 1986, Ch. 73, modified the Department's in-state producer issuance license fee to \$1,500 and the out-of-state producer issuance license fee to \$200. As of March 2022, these fee amounts have not changed and the Department was unaware of when its fees were last reviewed. Further, the Department has not conducted a cost analysis of its regulatory activities. Without accurate cost information, the Department cannot ensure that its fees are appropriately set, which may result in placing an undue cost burden on licensees or insufficient monies to cover Department costs. Our performance audit and sunset review of the Department in 2009 noted similar issues with the Department's fees, indicating that this has been an ongoing issue within the Department.<sup>43</sup>

- **Has not implemented Arizona Strategic Enterprise Technology Office (ASET)-required information technology (IT) procedures**—Arizona State agencies are required to develop IT security and data procedures consistent with the Arizona Department of Administration's ASET State-wide policies and credible industry standards. ASET's policies are intended to help State agencies implement recommended IT security procedures and to protect the State's IT infrastructure and the data contained therein. During the audit, we found the Department lacked written procedures in many areas required by ASET. For example, the Department lacked procedures for:

- **Data classification**—The Department does not classify its data—a process that involves identifying and evaluating its data to help ensure users appropriately secure the data on its network and shared drives and help prevent unauthorized data from being saved. By not implementing an effective data classification process, the Department is unable to ensure that sensitive data, including confidential information, is protected from loss, misuse, or disclosure.

#### Key terms

- **Data classification**—Identifies whether data is sensitive and stipulates how it should be protected.
- **Account management**—Designed to protect the operational security of information systems and minimize potential security vulnerabilities.

Source: Auditor General staff review of ASET policies and guidance.

- **Account management**—The Department has not evaluated and limited access to some of its IT systems and data to only Department staff who need this access to perform their job duties. For example, it provides all staff with unlimited access to licensing documents, which includes personal identifiable information, such as social security numbers. There is a high risk of unauthorized access and disclosure of sensitive data when too many users are granted unlimited data access.

- **Does not identify records eligible for destruction or follow record retention schedules**—The Department does not have a process for identifying records eligible for destruction or for appropriately deleting original paper and electronic documents containing sensitive information. Further, although the Arizona State Library, Archives and Public Records has posted document retention schedules for the Department to follow, it does not do so. Keeping records or data longer than the established retention period poses financial, legal, audit, and investigative risks to the Department.
- **Has not implemented important State requirements to protect public monies**—The Department accepts cash, checks, money orders, and payment cards in person, by mail, and online for licensing fees and fines. However, the Department had not implemented important State requirements to protect the public monies it collects, thereby increasing its risk of loss or theft. See Finding 1, pages 7 through 10, for additional information and recommendations.

<sup>42</sup> We reviewed fee-setting guidelines from the Arizona State Agency Fee Commission, the Government Finance Officers Association, the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review, the U.S. Government Accountability Office, and the U.S. Office of Management and Budget (see Appendix B, page b-2, for more information).

<sup>43</sup> See Arizona Auditor General report 09-08 *Arizona Department of Liquor Licenses and Control*.

Finally, we identified 2 areas where the Department has established but can further enhance its processes. Specifically, the Department:

- Followed applicable requirements for conducting the annual quota license lottery in 2021 but does not have policies and procedures to ensure continued compliance with these requirements**—As discussed in the Introduction (see page 1), statute limits the number of bar, beer and wine bar, and liquor store quota licenses that are made available to the public and the Department holds an annual lottery to issue these licenses. Specifically, A.R.S. §4-206.01 states that in each county, each year, the Director shall issue additional quota licenses at the rate of 1 of each license type for every additional 10,000-person increase over the county’s 2010 population.<sup>44</sup> Additionally, A.R.S. §4-206.01 states the Department may offer revoked and reverted quota licenses and reported it generally does so if it receives interest from the public.<sup>45</sup> The Department offers an annual lottery for available quota licenses to comply with the statutory and rule requirement that quota license applicants be prioritized by a random selection method prescribed by the Director if more than 1 person applies for an available license and conducted its most recent lottery in December 2021.<sup>46,47</sup> Table 2 provides information on the total number of quota licenses the Department offered in the December 2021 lottery by county, including whether these licenses resulted from a population increase or were revoked/reverted.

**Table 2**  
**Quota licenses offered in the December 2021 lottery by county and license type, resulting from population increases or revoked/reverted licenses**

County <sup>1</sup>	License type			Total population increase licenses offered	Total revoked or reverted licenses offered
	Bar	Beer and wine bar	Liquor store		
Cochise	1	1	1	-	3
Gila	1	1	-	-	2
Graham	1	-	-	-	1
La Paz	-	1	-	-	1
Maricopa	7	14	7	28	-
Mohave	-	1	-	-	1
Navajo	1	1	1	-	3
Pima	1	2	1	4	-
Pinal	6	5	2	13	-
Santa Cruz	1	1	-	-	2
Yavapai	-	2	-	1	1
Yuma	3	4	-	7	-
<b>Total</b>	<b>22</b>	<b>33</b>	<b>12</b>	<b>53</b>	<b>14</b>

<sup>1</sup> No quota licenses were offered in Apache, Coconino, and Greenlee Counties.

Source: Auditor General staff review of Department lottery documentation.

<sup>44</sup> Between August 9, 2017 and January 1, 2022, statute required beer and wine bar licenses to be issued at the rate of 1 for every 5,000-person increase over the 2010 population.

<sup>45</sup> According to A.R.S. §4-206.01, for every license that has been revoked or reverted in any county, the Director may issue a new license of the same series in the same county. A reverted license is a license that automatically returns to the State after it's held in continuous non-use in excess of 36 months. A.R.S. §4-206.01 further limits the number of quota licenses that can be offered each year to 5 new licenses plus an additional number of licenses equivalent to 20 percent of the difference between the number of revoked or reverted licenses per year and 5.

<sup>46</sup> A.R.S. §4-206.01(F) and AAC R19-1-204(C).

<sup>47</sup> The Department contracts with a certified public accounting (CPA) firm to conduct the lottery drawing. See Sunset Factor 12, page 29, for more information about this contract.

Our observation of the Department’s lottery drawing in December 2021 and review of lottery documentation found that the Department complied with statutory and rule requirements for offering quota licenses. For example, it provided notice through available media of its intent to issue new quota licenses as required by rule and randomly selected applicants through the lottery drawing to receive a quota license when there were more applicants than available licenses.<sup>48</sup> However, the process for determining the number of quota licenses that can be made available to the public in the lottery is largely handled by 1 Department staff member with minimal oversight. For example, this staff member determines the number of quota licenses available that will be offered by Department management to the public through the lottery and reported considering public interest when making this determination; however, the process this staff member undertakes is not reviewed, and any public interest received is not documented. Further, the Department lacks policies and procedures for its lottery process to help ensure continued compliance with statute and rule.

- **Requires in-state entity license applicants to submit fingerprints for purposes of conducting a criminal history records check but does not impose this same requirement for out-of-state license applicants**—A.R.S. §4-202(B) states that the Department Director shall require any license applicant, and may require a license applicant’s controlling person, to submit background information and a full set of fingerprints to the Department for a criminal history records check. Additionally, A.R.S. §4-202(A) requires licenses held through entities, such as corporations, and out-of-state applicants, to hold the license through an agent who files and signs documents on behalf of the applicant or licensee. Although the Department requires agents and controlling persons for in-state license applicants that are entities, such as corporations and limited liability companies, to submit fingerprints for purposes of conducting a criminal history records check, it does not require fingerprints for any out-of-state license applicants. Instead, the Department requires out-of-state license applicants to submit a copy of their home state license as part of the application process and reported that it relies on the out-of-state license applicant’s home state to have conducted a criminal history records check prior to issuing the home state license. However, it does not verify that the applicant’s home state has done so. By not requiring out-of-state license applicants to submit fingerprints for the purpose of conducting a criminal history records check, the Department cannot fully assess the applicants’ qualifications for licensure, including their criminal history, and imposes different application requirements on applicants.

**Key terms**

- **Controlling person(s)**—A person who directly or indirectly possesses the power to direct or cause the direction of the management and policies of an applicant or licensee.
- **Agent(s)**—A person designated by the applicant or licensee to receive communication from the Department, and to file and sign documents with the Department on behalf of the applicant or licensee.

Source: Auditor General staff review A.R.S. §§4-101 and 4-202.

**Recommendations**

The Department should:

8. Establish alcohol delivery contractor registration requirements and develop and implement rules and policies and procedures outlining these registration requirements and updating its registration application as needed. As part of the policies and procedures, the Department should include guidance for its staff on reviewing registration applications to help ensure applicants meet registration requirements.
9. Conduct a workload/cost analysis to evaluate whether its funding and staffing level is appropriate for administering the cocktails and alcohol to-go programs and work with the Legislature to revise the appropriations, as needed.

<sup>48</sup> AAC R19-1-204.

10. Develop and implement policies and procedures for periodically reviewing the appropriateness of its fees by analyzing the costs of its regulatory processes, comparing these costs to the associated fees, determining the appropriate licensing fees and surcharges, and then working with the Legislature to revise its fees as needed.
11. Develop a written action plan for developing and implementing ASET-required IT and data security procedures. The Department should then use this action plan to guide its efforts in developing and implementing written IT and data security procedures in line with ASET requirements and credible industry standards, focusing on the IT security areas with the highest security risks first. The action plan should include specific tasks, the status of those tasks, and their estimated completion dates, as well as a process for regularly reviewing and updating the plan based on its progress.
12. Develop and implement procedures for identifying records eligible for destruction and deleting original paper and electronic documents that contain sensitive information, as required by recommended practices.
13. Follow Arizona State Library, Archives and Public Records document retention schedules.
14. Develop and implement policies and procedures for offering quota licenses to the public, including procedures for:
  - Documenting public interest for quota licenses.
  - Determining the number of quota licenses that will be offered, including factors considered when making this determination.
  - Conducting a supervisory review of the process for determining the number of quota licenses that will be offered through the lottery.
15. Evaluate and revise its practices for ensuring that out-of-state license applicants meet all license requirements by verifying that these applicants have undergone a fingerprint-based criminal history records check.

**Department response:** As outlined in its [response](#), the Department agrees with the findings and will implement the recommendations.

**Sunset factor 3: The extent to which the Department serves the entire State rather than specific interests.**

The Department serves the entire State by regulating the sale, distribution, and production of alcohol across the State as follows:

- **Issuing liquor licenses to qualified applicants and managing licensees doing business in the State**—The Department issues licenses to qualified applicants to conduct business in the State, including licensees located in and outside of Arizona. As of February 2022, the Department had over 15,000 active licenses and privileges with most of these licenses being located in Arizona. Licensed establishments are located in each of the State’s 15 counties. Additionally, the Department provides licensing services in-person at its Phoenix office, online through its website and E-Licensing system, or through U.S. mail.
- **Investigating complaints and conducting inspections throughout the State to help ensure compliance with statute and rule**—The Department’s investigative and inspection functions are supported by 3 field offices with 11 assigned officers located in Phoenix, Tucson, and Winslow as of March 2022. Officers primarily investigate complaints alleging violations of State liquor laws and typically conduct inspections when already on-site at an establishment investigating a complaint. However, the Department reported that in fiscal year 2020, its ratio of investigative officers to liquor licenses was 1 to 1,474, and as such, it is unable to be “proactive” with enforcement, such as conducting more inspections independent of the complaint resolution process. The Department’s fiscal year 2023 budget request that it submitted to the Governor included monies for an additional 6 investigative officer positions and 1 sergeant position to

support the State-wide investigation of circumstances behind wrong-way driving auto-collisions, namely violations related to the overservice of liquor.

However, the Department did not comply with some State- and Department-specific conflict-of-interest requirements and had not fully aligned its conflict-of-interest process with recommended practices, such as requiring employees and Board members to complete a disclosure form upon hire/appointment, annually reminding all employees and Board members to update their disclosure form when their circumstances change, and maintaining a special file for substantial interest disclosures. We recommended that the Department develop and implement conflict-of-interest policies and procedures to help ensure it complies with State- and Department-specific conflict-of-interest requirements (see Finding 2, pages 11 through 15).

**Sunset factor 4: The extent to which rules adopted by the Department are consistent with the legislative mandate.**

Our review of all the Department's statutes and rules found that the Department has not developed some rules required by statute. Specifically:

- A.R.S. §4-112(G) requires that after January 1, 2019, the Department's rules for on-sale retailer basic training and on-sale retailer management training include procedures for security personnel assigned to monitor admission of patrons, interaction with patrons, calls to law enforcement, and strategies for the use of force and de-escalation techniques. According to the Department, it has not adopted these rules because of the Governor's moratoriums on State agency rulemaking.<sup>49</sup>
- A.R.S. §4-203(T) requires the Department to adopt rules establishing operational limits for the delivery of spirituous liquor. The Department reported it had not yet adopted these rules because the requirement to do so was recently added by Laws 2021, Ch. 375, which established the cocktails and alcohol to-go programs effective September 29, 2021 (see Questions and Answers, pages 30 through 35, for more information). Laws 2021, Ch. 405, also granted the Department an exemption from State rulemaking requirements for 1 year after the effective date of the cocktails and alcohol to-go legislation to adopt the required rules. As discussed in Sunset Factor 5 below, beginning in September 2021, the Department contracted with a rule writer to develop the rules for the cocktails and alcohol to-go programs, including establishing the operational limits for liquor delivery, and held a public comment meeting in January 2022 with stakeholders to solicit and accept input on the rules. However, the exemption granted by Laws 2021, Ch. 405, was voided by the Arizona Supreme Court in January 2022 and as a result, the Department halted any further work on its draft rules. Laws 2022, Ch. 282, effective September 24, 2022, grants the Department an exemption from State rulemaking requirements for 1 year to adopt rules for the cocktails and alcohol to-go programs.

**Recommendations**

The Department should:

16. Work with its Assistant Attorney General to seek an exemption from the rulemaking moratorium and adopt rules in accordance with A.R.S. §4-112(G).
17. Continue its rulemaking process to develop rules related to the cocktails and alcohol to-go programs.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendations.

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<sup>49</sup> Executive Order 2022-01 renewed the rulemaking moratorium on January 19, 2022.

**Sunset factor 5: The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.**

As previously discussed above in Sunset Factor 4, the Department contracted with a rule writer in September 2021 and started drafting rules in November 2021 for the cocktails and alcohol to-go programs but halted this effort after the exemption was voided by the Arizona Supreme Court. However, the Department held a public comment meeting in January 2022 with stakeholders to solicit and accept input on the cocktails and alcohol to-go programs.

We also observed 3 Board meetings held between September 2021 and February 2022 and found that the Board complied with the open meeting law requirements we reviewed. For example, the Department posted Board meeting notices and agendas on its website at least 24 hours in advance and Department staff provided written meeting minutes or recordings within 3 working days after the meetings. However, the Department has not developed policies and procedures related to open meeting law requirements. Written policies and procedures can help employees understand their duties and responsibilities regarding open meeting law requirements, thus helping to ensure the Department’s continued compliance with these requirements.

**Recommendation**

18. The Department should develop and implement open meeting law policies and procedures to help ensure the Board’s continued compliance with open meeting law requirements.

**Department response:** As outlined in its [response](#), the Department agrees with the finding and will implement the recommendation.

**Sunset factor 6: The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction and the ability of the Department to timely investigate and resolve complaints within its jurisdiction.**

Statute requires the Department to maintain a separate investigations unit that has the sole responsibility of investigating noncompliance with liquor laws, including any officer-initiated investigations.<sup>50,51</sup> Upon receiving a complaint, Department staff prioritize the complaint and assign it to an officer for investigation.<sup>52</sup> If the officer does not identify any violations, Department supervisors review the complaint investigation report and close the complaint as unactionable. If the officer identifies liquor law violations, the officer classifies the complaint as actionable and supervisors review the complaint investigation report and complaint classification, and forward the complaint to the Department’s compliance unit for disciplinary action (see textbox, page 24, for more information on the Department’s options for disciplinary action). Once a complaint is forwarded to the compliance unit, compliance staff should determine the discipline using the Department’s penalty guidelines. The guidelines permit staff to deviate from the penalty guidelines on a case-by-case basis and requires the deviation reason to be documented. The Department frequently resolves cases by offering the licensee a mail-in consent agreement which outlines the violation(s) and associated penalties, and if agreed upon, is signed by the licensee.

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<sup>50</sup> A.R.S. §4-112(C).

<sup>51</sup> As previously discussed, (see Introduction, page 2), Department officers, in addition to investigating complaints, can self-initiate investigations during the course of duty when they witness violations or are informed of potential violations by local law enforcement.

<sup>52</sup> Complaints are prioritized into 2 categories—priority-1 or priority-2. Priority-1 complaints include overservice to an “obviously intoxicated” person; selling to underage persons; and acts of violence occurring on the licensed premises or immediately adjacent to the premises. Priority-2 complaints include all other complaints alleging violations of liquor law. In March 2020, in response to the volume of executive order complaints, the Department developed an additional “executive order” complaint category. According to the Department, as of March 2021, it no longer had a separate category for executive order complaints since the executive orders pertaining to the COVID-19 pandemic and licensed establishments have been rescinded.

Although the Department generally followed its policies and procedures for investigating complaints and assessing and issuing penalties for liquor law violations for the complaints and investigations we reviewed, it did not always investigate complaints within its internal complaint-handling time frames, lacked a process to ensure all complaint allegations were investigated, lacked a time frame for resolving complaint cases forwarded to the compliance unit for disciplinary action, and did not always follow documentation requirements prescribed by its policies. Specifically, the Department:

- **Did not investigate 15 of 50 complaints we reviewed within its 35-day time frame**—According to Department policy,

complaint investigations are to be completed within 35 days of their receipt and either be closed as unactionable or marked as actionable and forwarded to the compliance unit to determine discipline. However, based on our review of 50 complaints the Department received and/or investigated in fiscal year 2021—consisting of both random and judgmental samples of complaints or investigations—the Department took between 37 and 185 days to investigate 15 of these complaints and either close the complaint as unactionable or forward the actionable complaint to the compliance unit for disciplinary action.<sup>53</sup> For example, the Department:

- Closed a complaint alleging that a gentlemen’s club was selling liquor after hours with underage patrons present 185 days after its receipt with no violations substantiated. However, the Department took 179 days to begin the investigation. Department staff reported that at the time the complaint was received, investigations of gentlemen’s clubs were temporarily suspended as a result of an internal affairs investigation within the Department.
- Took 100 days to investigate a complaint alleging an act of violence at a licensed establishment and forward it to the compliance unit for disciplinary action. Department staff reported that the officer’s investigation required followup with multiple witnesses, which accounted for the time required to investigate the complaint.

Department staff provided various reasons for not meeting the 35-day investigation time frame requirement for the remaining 13 complaints, including that the distance between the location of some licensed establishments and the nearest field office made it difficult to investigate the complaints or the influx of executive order complaints increased the Department’s complaint workload. Additionally, Department staff reported that previous Department leadership had directed the Investigations Division to temporarily prioritize investigations of executive order complaints over all other complaints from March 2020 through March 2021. Further, some complaint investigations may take longer than 35 days to investigate, such as those that involve serious injuries, death, or that require the receipt of subpoenaed information and/or police reports. However, the Department’s policies do not specify that these types of investigations may require more than 35 days to investigate or the documentation required to support an extension of the 35-day investigation time frame. As a result, the Department cannot determine if complaint investigations that exceed 35 days were timely investigated.

## Department options for disciplinary action

- Warning letter
- Civil penalty between \$200 and \$3,000 per violation<sup>1</sup>
- Suspension
- Revocation
- Refusal to issue or renew license

<sup>1</sup> The Department offers licensees a 50 percent discount on the civil penalty if the licensee agrees to, and signs, a mail-in consent agreement. Department policy allows this discount at the discretion of Department staff for first-time offenses that are considered minor violations, such as cases that do not require immediate response or action or concern for public safety.

Source: Auditor General staff review of A.R.S. §§4-210 and 4-210.01, Department policies, procedures, and documents, and interviews with Department staff.

<sup>53</sup> We reviewed a stratified random sample of 37 of 1,125 complaints the Department received in fiscal year 2021, including 20 of 161 priority-1 complaints, 10 of 271 priority-2 complaints, and 7 of 693 executive order complaints. Of the 161 priority-1 complaints, 11 were forwarded to the compliance unit for discipline, including 1 that we reviewed as part of the stratified sample. We judgmentally selected the remaining 10 complaints for review. Finally, we randomly selected 3 of 25 establishments that were assessed a civil penalty for violating the Governor’s COVID-19 executive orders and reviewed the associated fiscal year 2021 complaint or investigation.

- **Did not investigate all allegations in 1 complaint but developed a new process during the audit to help ensure all allegations are investigated**—Our review found that 1 complaint had 2 separate allegations—that a licensee’s employee was refilling liquor bottles and that drugs were being sold on the licensed premises, both of which are a violation of State liquor law.<sup>54</sup> Department staff forwarded the complaint to local law enforcement to investigate the allegation related to the sale of drugs.<sup>55</sup> However, although within its jurisdiction, the Department did not investigate the allegation related to refilling liquor bottles and instead forwarded the entire complaint to a local law enforcement agency for investigation. In response to our audit, the Department developed a new process for handling complaints with multiple allegations, when at least 1 of the allegations can be transferred to local law enforcement or another agency for investigation. Specifically, the new process requires Department staff to split multiple allegations from a single complaint into separate complaints when 1 of the allegations will be forwarded to another agency for investigation. This allows each allegation to be investigated by the appropriate authority or the Department, as applicable. Although the Department implemented this new process in March 2022, it has yet to revise its investigations policies and procedures to reflect this change.
- **Has not established time frames for resolving actionable complaints that are forwarded to the Department’s compliance unit**—According to recommended practices, agencies are expected to take appropriate, consistent, and timely enforcement actions that address the violations cited.<sup>56</sup> However, although the Department requires complaint investigations to be completed within 35 days, it has not established time frames for imposing disciplinary actions and resolving complaints once they are forwarded to its compliance unit to determine disciplinary action. For example, 1 of 50 complaints we reviewed took 231 days to resolve. The complaint involved allegations of overservice at a licensed establishment and once referred to the compliance unit, took an additional 178 days to determine disciplinary action and close the complaint. Department compliance unit staff reported that this complaint was delayed due to consent-agreement negotiations with the licensee and the case could not be closed until the licensee completed and showed proof of liquor law training.
- **Did not document deviations from penalty guidelines for 9 of 20 compliance cases and 3 of 6 hidden/undisclosed ownership cases we reviewed**—The Department has established penalty guidelines in policy to guide its determination of disciplinary action in response to substantiated violations. According to Department policy, compliance unit staff may deviate from the penalty guidelines if mitigating or aggravating circumstances are involved and are required to document the reason for the deviation. Our review of 2 different sample populations found the Department did not document its reasons for deviating from its penalty guidelines. Specifically:
  - Our review of a judgmental sample of 20 compliance cases that were forwarded to the compliance unit for discipline in fiscal years 2020 and 2021 found that Department staff did not follow the documentation requirements for 9 cases that deviated from the penalty guidelines, as required by Department policy.<sup>57</sup> Specifically, each of these 9 cases included aggravating circumstances, such as death and injuries, which the Department believed required stronger disciplinary action than the standard penalty guidelines directed. For example, in 1 case we reviewed, an individual crashed his vehicle resulting in injuries to multiple people. The Department determined that a licensed establishment overserved spirituous liquor to the individual, which contributed to the accident. As a result, the Department identified 3 violations of State liquor law involving the licensed establishment and its standard penalty guidelines indicated that these violations should collectively result in a \$4,500

<sup>54</sup> A.R.S. §4-244.

<sup>55</sup> Department staff reported that although allegations pertaining to drugs and illegal gambling are violations under State liquor law, its process is to forward these allegations for investigation by local law enforcement and the Arizona Department of Gaming, respectively.

<sup>56</sup> National State Auditors Association (NSAA). (2004). *Carrying out a state regulatory program: A National State Auditors Association best practices document*. Lexington, KY. Retrieved 5/4/2022 from [https://www.nasact.org/files/News\\_and\\_Publications/White\\_Papers\\_Reports/NSAA%20Best%20Practices%20Documents/2004\\_Carrying\\_Out\\_a\\_State\\_Regulatory\\_Program.pdf](https://www.nasact.org/files/News_and_Publications/White_Papers_Reports/NSAA%20Best%20Practices%20Documents/2004_Carrying_Out_a_State_Regulatory_Program.pdf).

<sup>57</sup> We reviewed a judgmental sample of 20 of the 44 compliance cases that contained an underage service or overservice violation from fiscal years 2020 and 2021.

fine. However, given the aggravating circumstances of the incident, the Department issued a \$9,000 fine and 7-day suspension to the licensed establishment, but this deviation from the guidelines was not documented as required by Department policy.

- We also reviewed all 6 investigations the Department conducted in fiscal years 2020 and 2021 that alleged a hidden/undisclosed ownership, 4 of which were forwarded to the compliance unit for disciplinary action.<sup>58</sup> Hidden/undisclosed ownership occurs when a person(s) has control of the licensed premises but has not been disclosed to the Department as a controlling person, with or without intent.<sup>59</sup> As a result, the undisclosed owner(s) has not submitted a license application to the Department providing the opportunity for the Department to ensure the applicant meets the qualifications for licensure, including a criminal history background check. Department staff did not document reasons for deviating from the Department's penalty guidelines for 3 of 4 hidden/undisclosed ownership cases when issuing penalties for violations identified. For example, in 2 cases, the Department revoked the license when its penalty guidelines indicated the violations identified should result in a civil penalty. However, the Department did not document its reasons for deviating from the penalty guidelines.

By not documenting the reason(s) for deviating from its penalty guidelines, the Department is at risk of not being able to support its penalty assessments or issuing inconsistent penalties for cases with similar violations.

## Recommendations

The Department should:

19. Investigate complaints within 35 days, as required by its policies and procedures.
20. Revise and implement its policies and procedures to require its staff to identify and monitor complaint investigations that may need to exceed the 35-day time frame to investigate, such as complaint investigations involving serious injuries, death, or that require the receipt of subpoenaed information and/or police reports, and document the reasons for complaint investigations exceeding the 35-day time frame requirement.
21. Develop and implement time frames in its policies and procedures for resolving complaint cases referred to its compliance unit for disciplinary action.
22. Continue to implement its new process for ensuring that all complaint allegations are investigated, either by investigating all allegations and/or forwarding applicable allegations to the appropriate authority for investigation, and revise its investigation policies and procedures accordingly.
23. Document explanations for all deviations from its established penalty guidelines as required by its policy.

**Department response:** As outlined in its [response](#), the Department agrees with the findings and will implement the recommendations.

## Sunset factor 7: The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation.

The Attorney General serves as the Department's legal advisor and provides legal services as the Department requires, according to A.R.S. §41-192(A)(1). Additionally, the Attorney General and county attorneys have the authority to prosecute cases that the Department investigates.

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<sup>58</sup> We reviewed all 6 hidden/undisclosed ownership investigations that had an inspection date in the Department's licensing and investigations system from fiscal years 2020 and 2021.

<sup>59</sup> A.R.S. §4-101 defines control as the power to direct or cause the direction of the management and policies of an applicant or licensee.

**Sunset factor 8: The extent to which the Department has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.**

According to the Department, there are no deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

**Sunset factor 9: The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in this sunset law.**

This performance audit and sunset review did not identify any statutory changes that are necessary to help the Department adequately comply with the factors listed in this sunset law.

**Sunset factor 10: The extent to which the termination of the Department would significantly affect the public health, safety, or welfare.**

Terminating the Department would affect the public's health, safety, and welfare if its responsibilities were not transferred to another entity. The Department helps promote public health and safety by regulating the manufacturing, sale, and distribution of spirituous liquor by issuing liquor licenses to qualified applicants and enforcing liquor laws in the State. As of February 2022, the Department had over 15,000 active liquor licenses and privileges and most were located within the State. According to recommended practices, proper licensure is a gatekeeping mechanism that may protect the public from unqualified or unscrupulous practitioners.<sup>60</sup> The Department is also responsible for ensuring that licensees comply with liquor laws by investigating complaints and conducting inspections. The Department investigates complaints of liquor law violations and has adopted a system for prioritizing complaint allegations of violations that can potentially harm the public. These complaints include violations associated with underage drinking, overservice of patrons, and acts of violence at licensed establishments. Additionally, the Department responds to wrong-way driver incidents as it reported that many of these incidents stem from overservice violations. According to the Arizona Highway Safety's fiscal year 2021 annual report, alcohol-impaired driving resulted in 17 percent of total vehicle fatalities in 2020.<sup>61</sup>

Finally, some research indicates that underage drinking contributes to a wide range of costly health and social problems, including motor vehicle crashes, and alcohol is a factor in the deaths of approximately 4,300 youths, on average, in the U.S. per year.<sup>62</sup> This review of underage drinking trends also noted that the enforcement of underage drinking laws is a critical component of prevention efforts, and enforcement can result in greater compliance and better public health outcomes.<sup>63</sup> According to the Department, officers identified and charged licensees with 283 counts of liquor law violations involving an underage person in fiscal year 2021. The Department's prevention unit further supports the Department's mission of promoting public safety by educating the public about the dangers of underage drinking.

**Sunset factor 11: The extent to which the level of regulation exercised by the Department compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.**

We compared the Department's level of regulation to the regulation exercised by a judgmental sample of similar departments in 3 other states—Florida, New Mexico, and Oklahoma—and found that the level and method of regulation the Department exercises is generally similar to these states.<sup>64</sup> We identified the following:

- **Enforcement**—All 4 states enforce liquor laws but 1 state has a separate agency perform this function. Specifically, Arizona, Florida, and Oklahoma each have liquor law enforcement divisions within their

<sup>60</sup> NSAA, 2004.

<sup>61</sup> Arizona Governor's Office of Highway Safety. (2021). *State of Arizona highway safety annual report*. Phoenix, AZ. Retrieved 5/23/2022 from [https://www.nhtsa.gov/sites/nhtsa.gov/files/2022-05/AZ\\_FY2021\\_AR.pdf](https://www.nhtsa.gov/sites/nhtsa.gov/files/2022-05/AZ_FY2021_AR.pdf).

<sup>62</sup> Harding, F.M., Hingson, R.W., Klitzner, M., Mosher, J.F., Brown, J., Vincent, R.M., Dahl, E., & Cannon, C.L. (2016). Underage drinking: A review of trends and prevention strategies. *American Journal of Preventive Medicine*, 51(4S2), S148-S157.

<sup>63</sup> Harding et al., 2016.

<sup>64</sup> See Appendix B, page b-2, for more information about how we selected these states.

respective departments. In contrast, New Mexico’s liquor department does not directly handle liquor law enforcement; instead, the New Mexico State Police’s Special Investigations Unit is responsible for enforcing New Mexico’s liquor laws.

- Penalty assessment**—Florida, New Mexico, and Oklahoma have penalty guidelines in their administrative rules that outline the assessment of penalties for noncompliance with these states’ liquor laws. However, as previously discussed, the Department has established penalty guidelines within Department policy (see page 25). All 4 states are permitted to deviate from their penalty guidelines.

Additionally, as shown in Table 3, the type of penalties each state assesses varies. For example, although all 4 states prohibit sales to both underage and intoxicated persons, the penalty assessment for a first-time offense, as outlined in each state’s penalty guidelines, varies for these violations.

**Table 3**  
**Penalty assessment for first offense of sales to underage and intoxicated persons by state**

	Arizona 	Florida 	New Mexico 	Oklahoma 
<b>Sale to underage person (first offense)</b>	\$1,000 to \$2,000	\$1,000 and 7-day suspension	\$1,000 to \$2,000 and 1-day suspension of alcohol sales	Revocation
<b>Sale to intoxicated person (first offense)</b>	\$1,500 and/or up to a 30-day suspension	\$1,000 and 7-day suspension	\$1,000 to \$2,000 and 1-day suspension of alcohol sales	Revocation

Source: Auditor General staff review of Arizona’s penalty guidelines, Florida Administrative Code Section 61A-2.022, Oklahoma Statutes Title 37a, and New Mexico Liquor Control Act Rules and Regulations.

- Quota licenses**—Arizona, Florida, and New Mexico use quota licenses to limit the number of certain licenses available in the state, while Oklahoma does not use quota licenses. For example, New Mexico issues a limited number of licenses for operating bars, full-service restaurants with bars, convenience stores that sell liquor, and nightclubs. Florida offers 2 types of quota licenses, both of which cover the sale of beer, wine, and liquor, but differ in whether the liquor is for consumption off or on the licensed premises.<sup>65</sup>
- Criminal history review**—Similar to Arizona, Florida and New Mexico require initial license applicants to submit fingerprints for a criminal history records check. However, as previously discussed (see page 20), Arizona does not require fingerprints for out-of-state license applications, while Florida and New Mexico have some limitations on who would not be required to submit fingerprints, such as individuals who are part of a publicly traded corporation.<sup>66</sup> Oklahoma does not require a set of fingerprints to be submitted with initial applications for purposes of conducting a criminal history records check. However, specific provisions in Oklahoma’s statutes permit it to deny an applicant for certain felony convictions. Neither Arizona nor any of the 3 states require fingerprints to be submitted for purposes of conducting a criminal history records

<sup>65</sup> Florida’s quota licenses are similar to Arizona’s liquor store and bar licenses.

<sup>66</sup> Arizona statute also does not require special event or fair/festival license applicants to submit fingerprints for a criminal history records check.

check at or prior to license renewal. However, Arizona requires its licensees to declare on the renewal application that they have not been convicted of a felony in the past 5 years.

- **Alcohol to-go privileges**—Arizona and all 3 states permit some form of alcohol to-go privileges. However, Arizona is the only state to require a separate permit or license to utilize these privileges (see Questions and Answers, pages 30 through 35, for more information about the cocktails and alcohol to-go programs).

**Sunset factor 12: The extent to which the Department has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.**

The Department uses private contractors to assist with some of its mission-critical functions. For example, the Department uses private contractors to assist with the annual lottery for quota liquor licenses (see pages 19 and 20 for more information about the lottery). To assist with conducting the December 2021 lottery, the Department awarded contracts to 2 independent professional appraisers to determine the fair market value of the offered quota liquor licenses, as required by statute, and 1 CPA firm to conduct a random drawing of the lottery winners.<sup>67,68</sup> Additionally, in response to Laws 2021, Ch. 375, which authorized the Department to establish cocktails and alcohol to-go programs, the Department contracted with a consulting firm to conduct a market analysis and study regarding the cocktails and alcohol-to-go leases, and a CPA firm to conduct a random drawing of bar and liquor store licensees to establish a priority order for entering into a lease with restaurants (see Questions and Answers, pages 30 through 35, for additional information about the cocktails and alcohol to-go programs).

We compared the Department's use of private contractors to those used by Florida, New Mexico, and Oklahoma and found that none of these states used private contractors for their mission-critical functions.

We did not identify any additional areas where the Department should consider using private contractors.

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<sup>67</sup> A.R.S. §4-206.01 states that to receive a quota license, a person must pay an additional issuance fee that is equal to the license's fair market value and an appraisal should be conducted to determine the fair market value of the license type in a specific county. A.R.S. §4-206.01 also requires the Director to employ 2 professional appraisers to determine the fair market value of quota licenses.

<sup>68</sup> A.R.S. §4-206.01(F) states that if more than 1 person applies for an available quota license, a priority of applicants shall be determined by a random selection method prescribed by the Director.

## Cocktails and alcohol to-go State law

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### Question 1: When was the cocktails and alcohol to-go State law passed?

The sale of cocktails and alcohol to-go first began during the COVID-19 pandemic. Specifically, in March 2020, the Governor issued an executive order, in an effort to limit the spread of COVID-19, that closed bars and restricted restaurants to serving customers only through pick-up, delivery, and drive-thru operations in counties that had confirmed COVID-19 cases.<sup>69</sup> The executive order also restricted the Department from enforcing some regulations, allowing restaurants to sell beer, wine, and spirituous liquor in sealed containers for consumption off premises, while restaurants were required to serve customers only through pick-up, delivery, and drive-thru operations.<sup>70</sup>

In May 2021, the Governor signed Laws 2021, Ch. 375, codifying the cocktails and alcohol to-go programs, which became effective September 29, 2021. After the passage of this law, a Governor's Office news release reported that the executive order helped mitigate the financial consequences of the COVID-19 pandemic-related pause on business operations and the law allows businesses the opportunity to expand operations.

### Question 2: What are the provisions of the cocktails and alcohol to-go State law?

As previously discussed (see Sunset Factor 2, page 17), Laws 2021, Ch. 375, amended and added various provisions to statute to modify or add privileges for existing licensees and created a new registration type. Specifically, there were the 3 following main provisions of the legislation:

<sup>69</sup> Executive Order 2020-09.

<sup>70</sup> The executive order required licensees to ensure the sale of alcohol to-go was only for consumption by individuals over the age of 21.

- Cocktails to-go**—The law allows bars and liquor stores to sell mixed cocktails to-go (see textbox for statutory requirements for preparing and selling cocktails to-go).<sup>71</sup> Additionally, the law requires bars and liquor stores to lease their cocktails to-go privilege to restaurant licensees.<sup>72</sup> To obtain a lease, a restaurant must apply to the Department and upon approval, the Department is required to randomly select and assign a bar or liquor store cocktails to-go privilege to the restaurant on a 1-year lease. During the lease term, the selected bar or liquor store leasing its privilege may also continue to sell cocktails to-go. Lease payments from the restaurant are sent to the Department, which the Department is then required to pay directly to the selected bar or liquor store. The Department was responsible for determining the lease amount, which should reflect the commercial value of the privilege to sell cocktails to-go (see pages 32 and 33 for more information on how the Department determined the lease amount). According to the Department, from October 2021 through May 2022, it collected nearly \$302,000 from restaurants that was then paid directly to the selected bar or liquor store for leasing their cocktails to-go privilege. Beginning January 1, 2026, this leasing process is repealed in statute. At that time, bars and liquor stores will retain their cocktails-to-go privileges, and the Department must make permits available for restaurants to purchase the privilege to sell and deliver cocktails to-go. The number of permits available for restaurants to purchase is required to be equal to the total number of bar and liquor store licenses in the State.<sup>73</sup>

- Alcohol to-go**—The law also allows bars, liquor stores, and beer and wine bar licensees to lease to a restaurant in the same county their license's off-sale privilege (alcohol to-go), which allows bars and liquor stores to sell spirituous liquor, and beer and wine bars to sell beer and wine, "to-go" in the original, sealed container.<sup>74,75</sup> Unlike cocktails to-go leases where the Department is required to randomly assign the privilege, bars, liquor stores, and beer and wine bars licensees (lessors) and restaurants have the choice to enter into a lease agreement and they can negotiate the lease amount. A restaurant licensee must apply to the Department for the alcohol to-go privilege by submitting a completed lease agreement signed by both the restaurant and lessor. During the lease term, lessors may not sell spirituous liquor for off-premises consumption, except for bars and liquor stores that can sell cocktails to-go. Lease payments from the restaurant are sent to the Department, and then the Department remits payment directly to the lessor. Although the law required the Department to determine a lease amount that reflects the commercial value of the alcohol to-go privilege, the law allows the lessor and lessee to agree to a different amount (see Question 3, pages 32 and 33 for more information on how the Department determined the lease



**Statute outlines requirements for preparing and selling cocktails to-go.<sup>1</sup>**

For example:

- The maximum capacity cannot exceed 32 ounces.
- The container must clearly display the bar's, liquor store's, or restaurant's logo or name.
- To-go mixed cocktails sold by restaurant licensees must be accompanied by the sale of menu food items.

<sup>1</sup> According to A.R.S. §4-101, mixed cocktails are spirituous liquor combined with at least 1 other ingredient, except water, such as fruit or vegetable juice, and once combined contains more than 0.5 percent of alcohol by volume.

Source: A.R.S. §§4-101 and 4-244.

<sup>71</sup> A.R.S. §4-203(S).

<sup>72</sup> A.R.S. §4-203.06.

<sup>73</sup> As previously discussed, (see Introduction, page 1), bar and liquor store licenses are quota licenses and are thereby limited by each County's population.

<sup>74</sup> A.R.S. §4-203.07.

<sup>75</sup> Entering into an alcohol to-go lease does not give restaurants access to a bar or liquor store's privilege to sell cocktails to-go.

amounts).<sup>76</sup> According to the Department, from October 2021 through May 2022, it collected nearly \$24,800 from restaurants that was then paid directly to the lessors for leasing their alcohol to-go privilege.

- **Order deliveries**—Finally, the law authorizes licensed bars, liquor stores, beer and wine bars and stores, and restaurants to fulfill orders for the sale and delivery of spirituous liquor (see textbox).<sup>77</sup> Licensees must collect payment for the full price of the spirituous liquor from the purchaser, such as by phone or online, before the spirituous liquor leaves the licensed premises. Further, liquor must be packaged by the licensee, or its employee, and containers should be tamper-proof sealed.

The law also amended statute to create a new registration type and outlines requirements for those who deliver spirituous liquor. Specifically, the law allows the Department to register any qualified person in Arizona as an alcohol delivery contractor to deliver spirituous liquor from a licensed bar, liquor store, beer and wine bar or store, or restaurant to a consumer in Arizona.<sup>78,79</sup> Delivery must be made by a person who is at least 21 years old and is a licensee’s employee or a registered alcohol delivery contractor’s employee or an authorized independent subcontractor. To receive a delivery, a customer must be at least 21 years old and display identification at the time of delivery.

### Sale and delivery of spirituous liquor authority by license type

**Bars and liquor stores**—The sale and delivery of cocktails to-go, beer, wine, and distilled spirits.

**Beer and wine bars and stores**—The sale and delivery of beer and wine.

**Restaurants**—The sale and delivery of cocktails to-go with the sale of food if the restaurant holds a cocktails to-go lease or permit; beer and wine if the restaurant holds an alcohol to-go lease with a beer and wine bar; beer, wine, and distilled spirits if the restaurant holds an alcohol to-go lease with a bar or liquor store; or beer if the restaurant holds the growler privilege.<sup>1</sup>

<sup>1</sup> Growler privileges allow restaurant licensees to sell beer for consumption off the licensed premises.

Source: Auditor General staff review of Laws 2021, Ch. 375 and A.R.S. §4-205.02(H).

## Question 3: How did the Department implement the cocktails and alcohol to-go programs?

The Department took the following steps to implement the provisions of Laws 2021, Ch. 375:

- **Determining application fees and lease amounts**—The law authorizes the Department to establish and charge application fees to pay for the administrative and enforcement costs associated with the cocktails and alcohol to-go leases and the costs of registering alcohol delivery contractors.<sup>80</sup> The Department conducted a workload analysis to assess its anticipated costs for processing applications to determine its application fees. This assessment determined how long it would take for its licensing and investigation divisions to review and approve an application. Based on this workload analysis and cost assessment, the Department developed various application fees (see textbox).

### Application fees paid to the Department

- **Cocktails to-go**—\$200 application fee.
- **Alcohol to-go**—\$200 application fee.
- **Registered alcohol delivery contractor**—\$100 application fee and \$25 annual renewal fee.

Source: Department’s December 2021 fee schedule.

<sup>76</sup> The law allowed the Department to establish separate lease amounts for urban and rural counties.

<sup>77</sup> A.R.S. §4-203(S).

<sup>78</sup> A.R.S. §4-205.13.

<sup>79</sup> Licensees may maintain a delivery service or may contract with 1 or more registered alcohol delivery contractors, who can contract with 1 or more independent subcontractors pursuant to A.R.S. §§4-203 and 4-205.13.

<sup>80</sup> A.R.S. §§4-203.06, 4-203.07, and 4-205.13.

The law also requires the Department to establish a lease amount reflecting the commercial value of the privilege to sell cocktails to-go and to identify and publish a lease amount for the commercial value of the privilege to sell alcohol to-go.<sup>81</sup> To determine the lease amounts, the Department contracted with a consulting firm to conduct a market analysis and study and recommend lease amounts. The Department also conducted surveys of affected licensees to help develop recommended lease amounts. Table 4 shows both the Department’s and contractor’s recommended lease amounts and the lease amounts the Department established and published. There was no requirement for the Department to adopt the contractor’s recommended lease amounts and for some of the leases, the Department established and/or published amounts that were higher or lower than the contractor’s recommendations. According to the Department’s Director, he considered the contractor’s and Department’s analyses and his own experience in setting the lease amounts and planned to reevaluate the lease amounts in early 2022.<sup>82</sup>

**Table 4**  
**Lease amounts determined by the Department Director and number of leases as of May 2022, as compared to Department and contractor’s analyses results**

	Department’s recommended lease amounts	Contractor’s recommended lease amounts	Lease amounts established/published by the Department	Number of leases as of May 2022
Cocktails to-go lease with bar or liquor store	\$3,200	\$4,500	\$1,000 <sup>1</sup>	125
Liquor to-go lease with bar or liquor store (urban county)	3,300	5,500	5,500	5
Liquor to-go lease with bar or liquor store (rural county)	3,500	5,000	5,000	0
Beer and wine to-go with beer and wine bar (urban county)	2,200	1,800	3,500	2
Beer and wine to-go lease with beer and wine bar (rural county)	1,800	1,350	2,800	0

<sup>1</sup> In March 2022, the Department’s Director lowered the cocktails to-go lease amount from \$2,500 to \$1,000, primarily based on low program participation and in an effort to increase participation (see page 34 for more information on how many licensees are participating in the programs).

Source: Auditor General staff review of the number of leases reported on the Department’s website as of May 2022, Department documentation, and sample leases.

<sup>81</sup> A.R.S. §§4-203.06 and 4-203.07. These amounts are required to fairly recognize and be derived from the commercial value of the privilege to sell cocktails or alcohol to-go. Additionally, statute states that the alcohol to-go lease amounts can be different for urban and rural counties.

<sup>82</sup> As discussed on page 31, beginning January 1, 2026, the leasing process for cocktails to-go is repealed, and the Department must make permits available for restaurants to purchase the privilege. As of April 2022, Department staff reported that the Department has not yet determined the permit fee amount.

- **Developing applications and leases and modifying its ELLI system**—The law required the Department to establish a process to facilitate and approve the leasing process, including establishing a standard lease form.<sup>83</sup> The law also states that restaurants may apply to the Department for a cocktail-to-go lease and individuals may apply with the Department to be a registered alcohol delivery contractor.<sup>84</sup> As such, the Department developed applications and standard leases for the cocktail and alcohol to-go programs.

The Department also worked with its vendor to modify ELLI, its licensing and investigations system, to make system changes to support the cocktails and alcohol to-go programs. These changes included creating new “license” types to represent the cocktails and alcohol to-go privileges and alcohol delivery contractor registrations; adding the fee amounts for the new privileges and registration; and allowing the Department to connect a restaurant license with a bar, liquor store, or beer and wine bar license within ELLI to indicate which licensees hold a lease together.

- **Developing a process to randomly select bar and liquor store licensees for cocktails-to-go leases**—As previously discussed (see page 31), the law requires the Department to randomly select and assign a bar or liquor store to enter a 1-year lease with a restaurant approved for a cocktails to-go privilege. The Department contracted with a CPA firm to conduct a random drawing of bar and liquor store licensees to establish a priority order for selecting these licensees to enter into a lease with restaurants as the restaurants applied for the cocktails-to-go privilege.
- **Providing education to licensees and the public**—The Department developed and posted on its website frequently asked question documents to educate the public and licensees on various aspects of the new law, including providing information on the cocktails to-go and alcohol to-go programs, and registered alcohol delivery contractors.
- **Drafting rules and soliciting stakeholder feedback**—As previously discussed in Sunset Factor 4 (see page 22), the law required the Department to adopt rules to set operational limits on the delivery of spirituous liquor. Additionally, Laws 2021, Ch. 405, granted the Department an exemption from State rulemaking requirements for 1 year after the effective date of the cocktails and alcohol to-go legislation. In September 2021, the Department contracted with a rule writer and in November 2021, started drafting rules for the cocktails and alcohol to-go programs. Additionally, as previously discussed, the Department also solicited public comments and held a public comment meeting on the proposed rules in January 2022 (see Sunset Factor 5, page 23, for more information). However, in January 2022, the Arizona Supreme Court voided Laws 2021, Ch. 405, including the Department’s exemption from State rulemaking requirements. As of April 2022, the Department had not finalized and adopted its rules. Laws 2022, Ch. 282, effective September 24, 2022, grants the Department an exemption from State rulemaking requirements for 1 year to adopt rules for the cocktails and alcohol to-go programs.

## Question 4: How many licensees are participating in the cocktails and alcohol to-go programs?

As of May 2022, 125 restaurants have entered into a cocktail to-go lease with a bar or liquor store, and 7 restaurants have entered into an alcohol to-go lease with a bar, liquor store, or beer and wine bar. However, the Department reported that it had not registered any alcohol delivery contractors as of May 2022.<sup>85</sup> As of May 2022, although the Department has developed an application and received 1 registration application, it has not established registration requirements. We recommended the Department establish alcohol delivery contractor registration requirements and develop and implement rules, policies, and procedures outlining these registration requirements and updating its application as needed. As part of these policies and procedures,

<sup>83</sup> A.R.S. §§4-203.06 and 4-203.07.

<sup>84</sup> A.R.S. §§4-203.07 and 4-205.13.

<sup>85</sup> As previously discussed on page 32, delivery can be made by a licensee’s employee.

the Department should include guidance for its staff on reviewing registration applications to help ensure applicants meet the registration requirements (see Sunset Factor 2, pages 17 through 20, for more information).

In January 2022, the Department reported that interest in the cocktails and alcohol to-go programs was declining and that some bars and liquor stores expressed concerns with the liability and insurance costs associated with randomly being selected to enter a lease with a restaurant for the cocktails to-go privilege. As a result, and according to Department records, some bars and liquor stores requested to “opt out” of being selected as a lessor for a cocktails to-go lease and although some of these bars and liquor stores were selected for a lease, they returned lease payments. Specifically, as of May 2022, 612 of the 2,855 bar and liquor store licensees, or approximately 21 percent, had requested to opt out of being selected for a cocktails to-go lease. Of these 612 bar and liquor store licensees, 32 had been selected for a lease but had returned their lease payment to the Department. Therefore, the Department paired the restaurant with another bar or liquor store licensee for the lease and these lease payments, totaling over \$42,000, were provided to the alternate bar or liquor store that was selected for the lease.

## Question 5: What additional funding did the Department receive for the implementation of this State law; how is the Department using it; and what is the Department doing to evaluate the appropriateness of this funding?

As previously discussed in Sunset Factor 2 (see page 17), for fiscal year 2022, the Department was appropriated \$1,025,000 and 6 FTE positions for the administration of cocktails to-go and alcohol to-go privileges and leases. This included a one-time \$200,000 appropriation for related automation costs. The Department actually spent \$218,574 to pay for the costs for the consulting firm to conduct research for determining the lease amounts and for its vendor to modify its ELLI system (see page 34 for more information on ELLI system changes and Sunset Factor 12, page 29, for more information on these contracts). Department staff reported that it will use the remaining and any ongoing appropriations to pay for the costs associated with employing the 6 FTE positions it established to administer the cocktails and alcohol to-go programs. As of May 2022, 5 of these positions are filled and 1 is vacant (see textbox for more information about these positions).

However, as previously discussed, Department staff reported that it has not evaluated whether this funding and staffing level is appropriate for the administration and enforcement of the cocktails and alcohol to-go programs. We recommended that the Department conduct a workload/cost analysis to evaluate whether its funding and staffing level is appropriate for administering the cocktails and alcohol to-go programs and work with the Legislature to revise the appropriations, as needed (see Sunset Factor 2, pages 17 through 20, for more information).

### Staff positions funded by the fiscal year 2022 appropriations, as of May 2022

- **Filled positions (5 FTE)**
  - Human resources / operations manager
  - Investigator
  - Customer service supervisor
  - Customer service representative
  - Auditor<sup>1</sup>
- **Vacant position (1 FTE)**
  - Administrative assistant

<sup>1</sup> Restaurants are required to derive at least 40 percent of gross revenue from the sale of food. A.R.S. §4-213 allows the Director to require a restaurant to submit an audit of its records to determine compliance during a 12-month period. According to Department staff, restaurants with a cocktails or alcohol to-go lease could be at a higher risk of not meeting the 40 percent requirement and the Department anticipates more audit needs as a result.

Source: Auditor General staff review of Department documentation, A.R.S. §§4-205.02 and 4-213, and interviews with Department staff.



# SUMMARY OF RECOMMENDATIONS

## Auditor General makes 23 recommendations to the Department

The Department should:

1. Record cash on the day received and deposit as soon as practicable, as required by the SAAM (see Finding 1, pages 7 through 10, for more information).
2. Continue its efforts to develop and implement an accurate mail log that includes:
  - Signatures from 2 employees not responsible for accounting records and who are present when the mail is opened.
  - Name of remitter; purpose of the remittance; amount of remittance; and form of remittance, such as cash, check, or money order (see Finding 1, pages 7 through 10, for more information).
3. Reconcile the mail log to amounts recorded and deposited and maintain documentation of the reconciliations, ensuring all cash received is recorded and deposited and discrepancies are investigated and resolved by employees who are not responsible for logging, recording, or depositing receipts, as required by the SAAM (see Finding 1, pages 7 through 10, for more information).
4. Develop and/or revise and implement written policies and procedures to help ensure staff comply with cash-handling requirements in the SAAM, including those outlined in recommendations 1 through 3 (see Finding 1, pages 7 through 10, for more information).
5. Update its conflict-of-interest disclosure form to include the additional requirements specified in A.R.S. §4-114 that are applicable to Department employees and Board members, and continue to ensure that its conflict-of-interest disclosure form addresses both financial and decision-making conflicts of interest for employees/Board members and their relatives, as required by statute (see Finding 2, pages 11 through 15, for more information).
6. Develop and implement conflict-of-interest policies and procedures to help ensure compliance with all State conflict-of-interest requirements, including A.R.S. §4-114, that require:
  - a. All Department employees and Board members to complete a conflict-of-interest disclosure form upon hire or appointment, including attesting that no conflicts exist, if applicable, and reminding them at least annually to update their disclosure form when their circumstances change, consistent with State requirements and recommended practices.
  - b. Using the updated conflict-of-interest disclosure form as recommended in Recommendation 5.
  - c. Storing all substantial interest disclosures, including disclosure forms and meeting minutes, in a special file available for public inspection, as required by statute.
  - d. Establishing a process to review and remediate disclosed conflicts, consistent with recommended practices (see Finding 2, pages 11 through 15, for more information).

7. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees and Board members on how the State's conflict-of-interest requirements and A.R.S. §4-114 relate to their unique programs, functions, or responsibilities (see Finding 2, pages 11 through 15, for more information).
8. Establish alcohol delivery contractor registration requirements and develop and implement rules and policies and procedures outlining these registration requirements and updating its registration application as needed. As part of the policies and procedures, the Department should include guidance for its staff on reviewing registration applications to help ensure applicants meet registration requirements (see Sunset Factor 2, pages 16 through 21, for more information).
9. Conduct a workload/cost analysis to evaluate whether its funding and staffing level is appropriate for administering the cocktails and alcohol to-go programs and work with the Legislature to revise the appropriations, as needed (see Sunset Factor 2, pages 16 through 21, for more information).
10. Develop and implement policies and procedures for periodically reviewing the appropriateness of its fees by analyzing the costs of its regulatory processes, comparing these costs to the associated fees, determining the appropriate licensing fees and surcharges, and then working with the Legislature to revise its fees as needed (see Sunset Factor 2, pages 16 through 21, for more information).
11. Develop a written action plan for developing and implementing ASET-required IT and data security procedures. The Department should then use this action plan to guide its efforts in developing and implementing written IT and data security procedures in line with ASET requirements and credible industry standards, focusing on the IT security areas with the highest security risks first. The action plan should include specific tasks, the status of those tasks, and their estimated completion dates, as well as a process for regularly reviewing and updating the plan based on its progress (see Sunset Factor 2, pages 16 through 21, for more information).
12. Develop and implement procedures for identifying records eligible for destruction and deleting original paper and electronic documents that contain sensitive information, as required by recommended practices (see Sunset Factor 2, pages 16 through 21, for more information).
13. Follow Arizona State Library, Archives and Public Records document retention schedules (see Sunset Factor 2, pages 16 through 21, for more information).
14. Develop and implement policies and procedures for offering quota licenses to the public, including procedures for:
  - Documenting public interest for quota licenses.
  - Determining the number of quota licenses that will be offered, including factors considered when making this determination.
  - Conducting a supervisory review of the process for determining the number of quota licenses that will be offered through the lottery (see Sunset Factor 2, pages 16 through 21, for more information).
15. Evaluate and revise its practices for ensuring that out-of-state license applicants meet all license requirements by verifying that these applicants have undergone a fingerprint-based criminal history records check (see Sunset Factor 2, pages 16 through 21, for more information).
16. Work with its Assistant Attorney General to seek an exemption from the rulemaking moratorium and adopt rules in accordance with A.R.S. §4-112(G) (see Sunset Factor 4, page 22, for more information).
17. Continue its rulemaking process to develop rules related to the cocktails and alcohol to-go programs (see Sunset Factor 4, page 22, for more information).

18. Develop and implement open meeting law policies and procedures to help ensure the Board's continued compliance with open meeting law requirements (see Sunset Factor 5, page 23, for more information).
19. Investigate complaints within 35 days, as required by its policies and procedures (see Sunset Factor 6, pages 23 through 26, for more information).
20. Revise and implement its policies and procedures to require its staff to identify and monitor complaint investigations that may need to exceed the 35-day time frame to investigate, such as complaint investigations involving serious injuries, death, or that require the receipt of subpoenaed information and/or police reports, and document the reasons for complaint investigations exceeding the 35-day time frame requirement (see Sunset Factor 6, pages 23 through 26, for more information).
21. Develop and implement time frames in its policies and procedures for resolving complaint cases referred to its compliance unit for disciplinary action (see Sunset Factor 6, pages 23 through 26, for more information).
22. Continue to implement its new process for ensuring that all complaint allegations are investigated, either by investigating all allegations and/or forwarding applicable allegations to the appropriate authority for investigation, and revise its investigation policies and procedures accordingly (see Sunset Factor 6, pages 23 through 26, for more information).
23. Document explanations for all deviations from its established penalty guidelines as required by its policy (see Sunset Factor 6, pages 23 through 26, for more information).



## Active liquor licenses and privileges, descriptions, and associated fees and surcharges

**Table 5**

Department-issued liquor license and privilege descriptions, number of active licenses and privileges, and associated licensing fees and surcharges  
As of February 2022

(Unaudited)

	Number of active licenses as of February 2022	Initial fee <sup>1</sup>	Annual license fee and applicable surcharges <sup>2</sup>
<b>Quota licenses<sup>3</sup></b>			
<b>Liquor store</b> —Allows licensees to sell spirituous liquors in the original, unbroken package for consumption off premises.	1,439	\$1,550	\$120
<b>Bar</b> —Allows licensees to sell and serve spirituous liquors, primarily by individual portions, for consumption on premises and in the original, unopened container for consumption off premises.	1,310	\$1,650	\$250
<b>Beer and wine bar</b> —Allows licensees to sell and serve only beer and wine, primarily by individual portions, for consumption on premises and in the original, unopened container for consumption off premises.	848	\$1,575	\$175
<b>Non-quota licenses</b>			
<b>Restaurant</b> —Allows licensed establishments serving food to also serve spirituous liquors for consumption on premises, but these establishments must generate at least 40 percent of their revenue from food sales.	4,208	\$2,000	\$585
<b>Beer and wine store</b> —Allows licensees to sell and serve beer and wine in original, unopened containers for consumption off premises.	2,338	\$1,550	\$120
<b>Out-of-state producer</b> —Allows out-of-state licensees to produce, export, import, or rectify spirituous liquor produced in other states and ship the spirituous liquor to Department-licensed wholesalers. <sup>4</sup>	1,834	\$50-\$600 <sup>5</sup>	\$95-\$370
<b>Direct shipment wine</b> —Allows licensed producers of wine from any U.S. state to ship limited amounts of wine produced at their wineries to Arizona residents. <sup>6</sup>	1,142	\$225	\$175
<b>Private club</b> —Allows licensees to sell and serve spirituous liquor for consumption at the club to only bona fide members of the club and their guests.	261	\$1,150	\$220

**Table 5 continued**

	Number of active licenses as of February 2022	Initial fee <sup>1</sup>	Annual license fee and applicable surcharges <sup>2</sup>
<b>Interim permits</b> —Conditional permit that allows the holder to temporarily sell and/or serve spirituous liquor while awaiting license approval.	259	\$100	--
<b>Hotel/Motel</b> —Allows licensed hotels/motels that have a restaurant to sell spirituous liquors for consumption on premises of the hotel/motel or by means of a mini-bar located in guest rooms. <sup>7</sup>	213	\$2,000	\$555
<b>Special events</b> —Allows licensees to temporarily sell spirituous liquor during special events.	138	\$25 per day	--
<b>Wholesaler</b> —Allows licensees to warehouse, sell, and distribute spirituous liquor to Department-licensed retailers or other Department-licensed wholesalers.	135	\$1,750	\$320
<b>Farm winery</b> —Allows licensees to sell and deliver wine produced on premises to other businesses licensed to sell wine, and to serve wine produced on premises for on and off-site consumption, including sampling.	123	\$200	\$170
<b>Microbrewery</b> —Allows licensees to sell and serve beer produced or manufactured on premises for on and off-site consumption, including sampling. <sup>8</sup>	118	\$600	\$370
<b>Government</b> —Allows licensees to serve and sell spirituous liquor on specified premises available only to a government entity. <sup>9</sup>	104	\$200	\$170
<b>Fairs and festivals</b> —Allows licensed farm wineries and craft distilleries to temporarily serve samples of their products or individual portions for consumption at the fair/festival or in original, unopened containers for consumption off premises.	50	\$15 per day	--
<b>Remote tasting room</b> —Allows licensed out-of-state or in-state farm wineries and craft distilleries to operate up to 2 tasting rooms to sell wine/distilled spirits to a consumer physically present on the premises for consumption on or off premises.	42	\$200	\$170
<b>In-state craft distillery</b> —Allows licensees to sell and serve distilled spirits produced or manufactured on premises for either consumption, including sampling, on premises, and in the original, sealed container for consumption off premises.	27	\$600	\$370
<b>In-state producer</b> —Allows licensees to produce or manufacture spirituous liquors in Arizona and sell/deliver these products to Department-licensed wholesalers.	23	\$1,850	\$420
<b>Conveyance</b> —Allows the owner or lessee of an operating airplane, train, or boat to sell spirituous liquors for consumption on the airplane, train, or boat.	22	\$1,725	\$295

**Table 5 continued**

	Number of active licenses as of February 2022	Initial fee <sup>1</sup>	Annual license fee and applicable surcharges <sup>2</sup>
<b>Alternating proprietorship</b> —Allows 2 or more licensed farm wineries, producers, craft distillers, or microbreweries to operate on 1 licensed premise.	15	\$200	\$100
<b>Custom crush</b> —Allows a licensed farm winery to supply grapes or other fruit to another licensed farm winery for the purposes of producing or manufacturing wine. <sup>10</sup>	12	\$100	\$100
<b>Privileges</b>			
<b>Liquor store and beer and wine store sampling</b> —Allows licensed liquor stores and beer and wine stores to offer limited amounts of distilled spirits, beer, or wine at no cost for the purposes of customer sampling.	466	\$100	\$60
<b>Restaurant growler</b> —Allows licensed restaurants to dispense beer from the tap and sell for consumption off premises. <sup>11</sup>	235	\$225	\$150
<b>Bring-your-own-bottle (BYOB)</b> —Provides unlicensed businesses a statutorily authorized exemption to allow customers to possess and consume limited amounts of spirituous liquor while at the business obtaining goods or services regularly offered to all customers. <sup>12</sup>	135	\$50	--
<b>Cocktails and alcohol to-go</b> —Allows licensed restaurants to enter a lease with a licensed bar or liquor store to sell and deliver mixed cocktails, or with a licensed bar, liquor store, or beer and wine bar to sell and deliver spirituous liquor or beer and wine for consumption off premises. <sup>13</sup>	112	\$200 <sup>14</sup>	--
<b>Total active licenses and privileges</b>	<b>15,609</b>		

<sup>1</sup> The Department’s initial fee consists of a 1-time issuance fee plus an annual license fee. However, A.R.S. §4-209(C) and AAC R19-1-102(B) state that if a license is issued less than 6 months before the scheduled renewal date of the license, only half of the annual license fee shall be charged. After license issuance, licensees pay the annual license fee each year at renewal.

<sup>2</sup> A.R.S. §4-209 authorizes the Department to assess 3 separate surcharges in addition to annual license fees, ranging from \$20 to \$35. These surcharges are applicable to different license types and may be combined for some licenses. For example, bars and beer and wine bars are required to pay all 3 surcharges—totaling \$100. A.R.S. §4-209 also authorizes the Department to charge a \$150 late fee for licensees who fail to renew their licenses on or before the annual renewal date.

<sup>3</sup> Pursuant to A.R.S. §4-206.01(D), in addition to the fees listed in the table, applicants for new quota liquor licenses must pay an additional issuance fee equal to the license’s fair market value, which is required to be remitted to the State General Fund. The Department’s quota license issuance fees ranged between \$7,050 and \$288,600 in December 2021, depending on the license type and the county in which the quota license was located.

<sup>4</sup> Out-of-state producers also include craft distillers, limited wineries, farm wineries, and microbreweries.

<sup>5</sup> The initial fee for out-of-state producer licenses varies by license type, with amounts ranging from \$50 to \$600. For example, the fee for limited wineries is \$50, whereas the fee for distilleries and microbreweries is \$600.

<sup>6</sup> According to A.R.S. §4-203.04, direct shipment licensees must hold a federal basic permit issued by the United States Alcohol and Tobacco Tax and Trade Bureau and a current license to produce wine issued by Arizona or any other state.

<sup>7</sup> Hotel and motel restaurants are subject to the same restaurant requirements as outlined in A.R.S. §4-205.02 and AAC R19-1-206.

<sup>8</sup> A.R.S. §4-205.08 requires microbreweries to produce at least 5,000 gallons of beer following its first year of operation and not more than 6.2

## Table 5 continued

million gallons of beer annually. Additionally, microbreweries may sell beer from other microbreweries, but those sales may not exceed 20 percent of the licensee's annual sales of beer by volume at the premises.

- <sup>9</sup> A.R.S. §4-101(18) defines a government license as 1 issued to a State agency, State board, State commission, county, city, town, community college or State university, the National Guard, or Arizona Coliseum and Exposition Center.
- <sup>10</sup> According to A.R.S. §4-205.04(E), the winery receiving the fruit shall be licensed by the United States Alcohol and Tobacco Tax and Trade Bureau and the Department. The winery producing the fruit must be licensed by the Department.
- <sup>11</sup> According to A.R.S. §4-244(32)(C), a restaurant with a growler privilege is authorized to dispense beer, not to exceed 1 gallon, for consumption off premises if the container is filled by a licensee's employee at the tap at the time of sale, is sealed, and displays a government warning label.
- <sup>12</sup> Pursuant to A.R.S. §4-244.05, unlicensed establishments are not permitted to allow the consumption of spirituous liquor in the establishment or on the premises. However, statute authorizes establishments to seek an exemption to allow for the possession or consumption of spirituous liquor only as an incidental convenience to customers. AAC R19-1-324 requires unlicensed businesses to apply for this exemption, referred to by the Department as a "BYOB privilege."
- <sup>13</sup> For more information on cocktails and alcohol to-go, including privileges added in statute for licensed bars, liquor stores, and beer and wine bars, see Questions and Answers, pages 30 through 35.
- <sup>14</sup> As discussed in the Questions and Answers (see pages 31 through 33), in addition to the \$200 application fee that is paid to the Department, licensed restaurants are required to provide payment to the licensed bar, liquor store, or beer and wine bar for the lease.

Source: Auditor General staff review of A.R.S. Title 4, AAC, Title 19, Ch. 1, and the Department's February 2022 licensing data, December 2021 fee schedule, and licensing guidance.

## Scope and methodology

The Arizona Auditor General has conducted a performance audit and sunset review of the Department pursuant to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to address the audit's objectives. These methods included reviewing the Department's statutes, rules, website, and policies and procedures, and interviewing Department staff and the Board chair. In addition, we used the following specific methods to meet the audit objectives:

- To determine whether the Department processed, recorded, and timely deposited cash receipts in accordance with State requirements specified in the SAAM, we reviewed the Department's safe contents in December 2021 and February 2022 and reconciled the Department's mail log to the safe contents as of February 7, 2022.<sup>86</sup> Additionally, we reviewed a judgmental sample of 35 transactions totaling approximately \$8,857,657 from the 14,707 transactions totaling \$24,694,675 recorded in AFIS for the period July 1, 2019, through October 31, 2019.<sup>87</sup> Further, we reviewed a random sample of 6 cash payments totaling \$1,154 and 10 checks totaling approximately \$171,067 from the Department's February 7, 2022, mail log to determine if the amounts had been recorded and deposited.
- To assess the Department's compliance with State conflict-of-interest requirements and alignment with recommended practices, we reviewed statute and ADOA requirements, recommended practices, and the Department's practices and its conflict-of-interest disclosure form for Board members.<sup>88,89</sup>
- To determine whether the Department issued initial licenses to qualified applicants in accordance with statute and rule requirements in a timely manner, we reviewed a random sample of 20 of the 2,628 initial licenses the Department issued in fiscal year 2021. To determine whether the Department renewed licenses according to its statutes and rules, we reviewed a random sample of 10 of the 14,104 licenses renewed in fiscal year 2021. Additionally, we also observed the Department's December 2021 quota license lottery for offering quota licenses and reviewed the Department's lottery documentation.
- To assess the Department's complaint-resolution process, including the timeliness of complaint resolution, we reviewed 50 of the 1,125 complaints the Department received and/or investigated in fiscal year 2021.

<sup>86</sup> The SAAM contains the State's accounting policies and procedures and is published by the Arizona Department of Administration's General Accounting Office in accordance with statute.

<sup>87</sup> We sampled these transactions based on their classification, which included licensing fees, fines, penalties, and other licensing fees, such as fair market value payments for quota liquor licenses.

<sup>88</sup> Recommended practices we reviewed included: Organization for Economic Cooperation and Development (OECD). (2021). *Recommendation of the Council on OECD guidelines for managing conflict of interest in the public service*. Paris, France. Retrieved 2/15/2022 from <https://legalinstruments.oecd.org/public/doc/130/130.en.pdf>; Ethics & Compliance Initiative (ECI). (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 2/15/2022 from <https://www.ethics.org/wp-content/uploads/2021-ECI-WP-Conflicts-of-Interest-Defining-Preventing-Identifying-Addressing.pdf>; and Controller and Auditor General of New Zealand. (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 2/15/2022 from <https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf>.

<sup>89</sup> In response to conflict-of-interest noncompliance and violations investigated in the course of our work, we have recommended several practices and actions to various school districts, State agencies, and other public entities. Our recommendations are based on guidelines developed by public agencies to manage conflicts of interest in government and are designed to help ensure compliance with State conflict-of-interest requirements. See, for example, Auditor General Reports 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

This included a stratified random sample of 37 complaints consisting of 20 of 161 priority-1 complaints, 10 of 271 priority-2 complaints, and 7 of 693 executive order complaints. Of the 161 priority-1 complaints, 11 were forwarded to the compliance unit for discipline, including 1 that we reviewed as part of the stratified sample. We judgmentally selected the remaining 10 complaints for review. Additionally, we randomly selected 3 of 25 establishments that were assessed a civil penalty for violating the Governor's COVID-19 executive orders and reviewed the associated fiscal year 2021 complaint/investigation. To determine whether the Department imposed discipline consistent with its policies, we judgmentally selected and reviewed a sample of 20 of 44 compliance cases that contained an underage service or overservice violation from fiscal years 2020 and 2021 and all 6 hidden/undisclosed ownership investigations that had an inspection date in the Department's licensing and investigations system from fiscal years 2020 and 2021.

- To evaluate the Department's compliance with the State's IT security requirements and credible industry standards, we compared the Department's IT policies, procedures, and practices to ASET requirements and credible industry standards. We also conducted interviews with Department staff, analyzed Department-provided data, observed the Department's licensing system, and assessed whether the Department was limiting access to its licensing system. Additionally, we assessed the Department's compliance with Arizona State Library, Archives and Public Records' document retention schedules.
- To obtain information for the Introduction, we reviewed Department-provided information regarding Department and Board member vacancies as of May 2022. Additionally, we reviewed Department data to determine the number of active licensees as of February 2022, and the number of inspections and restaurant audits completed in fiscal year 2021. Finally, we compiled and analyzed unaudited financial information from the AFIS *Accounting Event Transaction File* for fiscal years 2020 and 2021, the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021, and Department-provided estimates for fiscal year 2022.
- To obtain additional information for the Sunset Factors, we assessed the Board's compliance with various provisions of the State's open meeting law for 3 Board meetings held from September 2021 through January 2022. In addition, to determine whether the Department appropriately established fees, we interviewed Department staff, reviewed the Department's statutes and rules, and reviewed the Department's revenues, expenditures, and fund balances for fiscal years 2020 and 2021, and estimated balance for fiscal year 2022. We also reviewed fee-setting standards and guidance developed by government and professional organizations.<sup>90</sup> To determine the extent to which the Department served the entire State, we reviewed all active liquor licenses and privileges as of February 2022 and the number and placement of investigation offices and field officers as of March 2022. To assess the Department's impact on public health, safety, or welfare, we reviewed literature on underage drinking trends and prevention strategies as well as the State of Arizona Highway Safety 2021 Annual Report's statistics on alcohol-impaired driving and vehicle fatalities.<sup>91</sup> Finally, we judgmentally selected and contacted 3 states—Florida, New Mexico, and Oklahoma—and reviewed their regulation and enforcement of the liquor industry and use of private contractors.<sup>92</sup>

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<sup>90</sup> We reviewed the following fee-setting recommended practices: Arizona State Agency Fee Commission. (2012). *Arizona State Agency Fee Commission report*. Phoenix, AZ; U.S. Government Accountability Office. (2008). *Federal user fees: A design guide*. Washington, DC. Retrieved 5/12/2022 from <https://www.gao.gov/assets/gao-08-386sp.pdf>; Michel, R.G. (2004). *Cost analysis and activity-based costing for government*. Chicago, IL: Government Finance Officers Association; Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review. (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS. Retrieved 5/12/2022 from <https://www.peer.ms.gov/reports/rpt442.pdf>; and U.S. Office of Management and Budget. (1993). *OMB Circular No. A 25, revised*. Washington, DC. Retrieved 5/12/2022 from <https://www.whitehouse.gov/wp-content/uploads/2017/11/Circular-025.pdf>.

<sup>91</sup> Harding, F.M., Hingson, R.W., Klitzner, M., Mosher, J.F., Brown, J., Vincent, R.M., Dahl, E., & Cannon, C.L. (2016). Underage drinking: A review of trends and prevention strategies. *American Journal of Preventive Medicine*, 51(4S2), S148-S157; and Arizona Governor's Office of Highway Safety. (2021). *State of Arizona highway safety annual report*. Phoenix, AZ. Retrieved 5/23/2022 from [https://www.nhtsa.gov/sites/nhtsa.gov/files/2022-05/AZ\\_FY2021\\_AR.pdf](https://www.nhtsa.gov/sites/nhtsa.gov/files/2022-05/AZ_FY2021_AR.pdf).

<sup>92</sup> We selected these states because all 3 states regulate wholesalers, distributors, and retailers, and have large Native American populations that may require additional considerations for tribal lands like Arizona. We also considered whether these states had some form of alcohol to-go privileges and their own liquor law enforcement division.

Our work on internal controls included reviewing the Department's policies and procedures for ensuring compliance with Department statutes and rules, and, where applicable, testing its compliance with these policies and procedures, including compliance with State IT security or credible industry standards. Our internal control work included reviewing the following components of internal controls: control activities, risk assessment, and monitoring. We reported our conclusions on internal control deficiencies in Findings 1 and 2, and in our responses to the statutory sunset factors.

We selected our audit samples to provide sufficient evidence to support our findings, conclusions, and recommendations. Unless otherwise noted, the results of our testing using these samples were not intended to be projected to the entire population.

We conducted this performance audit and sunset review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We express our appreciation to the Department and its staff for its cooperation and assistance throughout the audit.

# DEPARTMENT RESPONSE



STATE OF ARIZONA  
DEPARTMENT OF LIQUOR LICENSES AND CONTROL

Douglas A. Ducey  
GOVERNOR

Tracy Uffelman  
DIRECTOR

July 21, 2022

Lindsey Perry  
Auditor General  
2910 N 44<sup>th</sup> St, Ste. 410  
Phoenix, AZ 85018

Dear Auditor General Perry:

On behalf of the Arizona Department of Liquor Licenses & Control (DLLC), we would like to thank you for providing us with a detailed and meticulous audit of our agency. We appreciate you identifying gaps, vulnerabilities and opportunities for the agency to become stronger and more efficient to serve the citizens of Arizona. Many of your findings have already been fixed and implemented, with others in the process. Ten (10) months ago I assumed an agency in distress with no leadership, guidance or vision for the future. Employee morale was dismal and collaboration with the liquor industry was non-existent. This has all quickly changed, and I'm proud to report the positive steps my Deputy Director and I have taken in regard to professional direction, needed funding and growth, and increased training which has led to high morale at DLLC in less than a year.

We are focused on four (4) key Public Safety Tenets: Wrong Way Drivers, Overservice, Underage Drinkers & Violent Acts. This has set the priority for our detectives and our agency as a whole to focus on.

We have collaborated and closely aligned with the Governor's Office of Highway Safety to receive grant funding, and have purchased a new DLLC Mobile Command Vehicle to be used at Major Events. This provides a professional image for the agency when representing the Governor's Office at Large Scale Events, and replaces an old platform that was not operationally sound or professional in appearance. We have streamlined our Licensing Unit to be more efficient and responsive to our citizens and stakeholders when processing applications of various liquor licenses. At the same time, we have

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enrolled our two (2) Licensing Supervisors in an intense DPS led Leadership Training Course to develop and enhance their skills for the future.

We have increased staffing in the Licensing Section, Audit Unit and Investigation Squad, with more detective hiring planned in FY23 and FY24 to align with the national average of liquor licenses/detective ratio.

We have also filled key leadership roles with an Assistant Director, and a much needed Public Information Officer/Legislative Liaison, while at the same time being flexible by creating a hybrid remote work schedule that is laser focused on customer support for questions and guidance.

Within the last (30) days we have secured a one-time line item in our budget of 3.5 million dollars for a complete remodel of our 5th floor office space, which has not been updated since the 1970's. This floor to ceiling remodel will tremendously help with employee morale, recruitment, retention and overall cleanliness. At the same time, we have secured and moved into our own much needed space in Tucson, and are actively pursuing DLLC space in Flagstaff for our detectives.

We have been closely engaged and very responsive with ADOA, OSPB and the Arizona House & Senate to meet their needs, and appropriately reclassify roles, provide bonuses and execute meaningful pay raises to our employees which had been ignored in years past. We have held quarterly one-on-one meetings with companies, executives and representatives of the liquor industry to create a positive working environment and change to the philosophy of "Pro Business and Open Commerce" instead of an adversarial "us vs them" mentality. For the first time in decades, I have placed Reverted and Revoked licenses back into the economy through the Liquor Lottery to be held in late July, 2022, which will stimulate growth, create jobs and generate funding for the State of Arizona.

We have much work ahead of us, but all of these things, and many more; have led to a positive change and promising future at the DLLC.



Tracy Uffelman  
Director, DLLC



STATE OF ARIZONA  
DEPARTMENT OF LIQUOR LICENSES AND CONTROL

Douglas A. Ducey  
GOVERNOR

Tracy Uffelmann  
DIRECTOR

July 21, 2022

Lindsey Perry  
Auditor General  
2910 N 44<sup>th</sup> St, Ste. 410  
Phoenix, AZ 85018

Dear Auditor General Perry:

My leadership team and I have reviewed the preliminary audit report draft for the Department of Liquor. After reviewing the report, no accuracy concerns were identified with the findings. Below are the responses for each of the twenty-three (23) recommendations and a brief explanation. The Department agrees with all of the findings of the Auditor General and the audit recommendations will be implemented.

The members of the Liquor Board also responded to any recommendations that concerned them and their responses were added in part to the explanation response section. One of the board members, Mr. David, replied, "Comments regarding personalities, politics and management styles were avoided. The findings and recommendations were fair and focused on major issues while avoiding trivial matters. In my opinion, the auditor's comments regarding financial and accounting deficiencies were helpful without being overly harsh. I appreciated that punitive recommendations were absent."

Rec #	Department Agrees with finding, will implement recommendation	Explanation Response
1	Yes	The Department has had the computer system changed so that we can now record all monies as they are received.
2	Yes	The Department has developed and implemented a new mail

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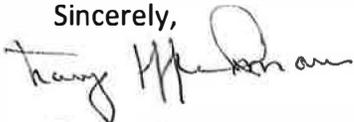
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		log that captures the required information.
3	Yes	The Department will reconcile the mail log to amounts recorded and deposited and maintain documentation of the reconciliations.
4	Yes	The Department will develop and implement written policies and procedures to help ensure staff comply with SAAM requirements.
5	Yes	The Department's HR employee will keep an updated conflict of interest disclosure form to meet statutory requirements. Each employee and board member signed the updated form.
6	Yes	The Department's HR employee will develop and implement conflict of interest policies and procedures.
6a	Yes	New and current employees have completed a conflict of interest disclosure form and will be reminded annually to update them. Board members will receive theirs at the January hearings.
6b	Yes	The Department's HR employee will ensure to use the updated conflict of interest disclosure form as recommended.
6c	Yes	The Department's HR employee will store all substantial interest disclosures and forms, and meeting minutes in a special file available for public inspection.
6d	Yes	The Department's HR employee will establish a process to review and remediate disclosed conflicts.
7	Yes	The Department's HR employee will develop and provide training on conflict of interest requirements, process and the form. Employees and board members received training in April.
8	Yes	The Department will establish alcohol delivery contractor registration requirements (drivers), and develop, and implement rules, policies and procedures.
9	Yes	The Department will conduct a workload/cost analysis to evaluate whether current funding and staffing level is appropriate for administering cocktails to go and work with the Legislature to revise the appropriations if needed.
10	Yes	The Department will develop and implement a policy for reviewing licensing fees and associated costs to determine if we need to adjust fees.
11	Yes	The Department's IT staff will develop a written action plan for developing and implementing ASET-required IT and data security procedures.
12	Yes	The Department will develop and implement procedures for identifying records eligible for destruction as required.
13	Yes	The Department will follow the Arizona State Library, Archives, and Public Records document retention schedules.
14	Yes	The Department will develop and implement policies and procedures for offering quota licenses to the public.
15	Yes	The Department will ensure that out of state applicants meet all license requirements by verifying they have undergone a fingerprint –based criminal history records check in their home state.

16	Yes	The Department is in the process of amending and adding new rules.
17	Yes	The Department now has the exemption to write new rules for Alcohol to Go.
18	Yes	The Department will develop and implement open meeting law policies and procedures.
19	Yes	The Department's investigation division will attempt to investigate and close priority one complaints within 35 days.
20	Yes	The Department will revise and implement its policies and procedures to require its staff to identify and monitor complaint investigations that may need to exceed the 35-day time frame to investigate.
21	Yes	The Department will develop and implement policies and procedures for the compliance department to establish some timeframes to resolve cases. Some high profile or severe cases may take longer to resolve.
22	Yes	The Department will investigate all allegations of a complaint or forward parts to the appropriate agency and revise the policies to reflect this.
23	Yes	The compliance department will document explanations for all deviations from its established penalty guidelines per policy.

Sincerely,



Tracy Uffelman  
Director

